


BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**Office Correspondence**Date April 12, 1939.To Chairman Eccles

Subject: \_\_\_\_\_

From Mr. RansomCONFIDENTIAL

I think you will find the attached, which is from the Committee on Monetary Policy and Credit of the International Chamber of Commerce, interesting. It was referred to in one of Mr. Merle Cochran's confidential letters. He sent me the original from which the enclosed copy is made, and, while it is not marked "Confidential", it is asked that you will so treat it due to the channels through which it came to my notice. It was issued some time the latter part of 1938.

A handwritten signature in black ink, consisting of several overlapping loops and a horizontal line at the bottom.

INTERNATIONAL CHAMBER OF COMMERCE  
 INDUSTRY-BANKING-TRADE-TRANSPORT  
 HEADQUARTERS  
 No.58, Cours Albert 1<sup>er</sup> - Paris,VIII<sup>e</sup>

Financial Department  
 VDR.

Document N<sup>o</sup> 6665 - or.  
 18.10.1938 - sc.

COMMITTEE ON MONETARY POLICY AND CREDIT

PUBLIC EXPENDITURES AND PROSPERITY

1. For some years - more especially since the economic and financial crisis of 1929/32 threw business into a chaos from which it seemed incapable of extricating itself by its own strength - the Governments of a number of countries have played a prominent and possibly increasing part in economic affairs. Lower interest and protective tariffs and quotas have been resorted to. But in addition, Government expenditure on a large scale has been directly deployed to assist or maintain economic recovery.

2. Both the manner of Government spending and the methods of financing such expenditure have varied greatly as between one country and another; and the results achieved have been divergent in different countries and under different conditions.

3. The objects, or avowed objects, have not everywhere been the same; though, generally speaking, they have all stood in more or less close relation to the problem of reducing unemployment, which - having reached some 30,000,000 according to League of Nations estimates in 1932/33 - was the most urgent economic and indeed political issue confronting statesmen.

4. Almost at once, however, striking dissimilarities are apparent in the treatment adopted and in the results that followed. If due allowance is made for the special characteristics of particular countries, there may remain, in abstraction from these, a field for study and discussion of the general scope and potentialities, the uses and the abuses of Government expenditure and entrepreneurial activities - and of the various methods of financing these - as a means of counteracting depression and unemployment and of securing prosperity and stability.

5. In the United-States, as is well known, Government finance was at first used to rescue the banking structure. Or rather, even before that, it had been used to support the price of wheat. Later it also came to the rescue of cotton. That is, apart from saving the depositors' money, the Government endeavoured to raise and to prop up the price-structure. Again, at another juncture, it itself entered the field of public utility and other enterprise, calculated to afford employment directly, to large numbers of workmen. Relief and recovery activities of the U. S. Government cover, altogether, a wide field.

6. From the outset, the American Government, though it increased taxation, had recourse to loans for the requisite finance. The National Debt has thereby been doubled in relatively few years. And when at the beginning of 1937 the Administration took steps to reduce relief expenditure (in the widest sense), in order gradually to terminate a régime déficitaire, a deflationary impetus arose, causing a sharp economic relapse and rise in unemployment. Prices also fell back, though as regards wheat and cotton special causes were at work. In any case, prosperity suffered a

- 2 -

drastic setback. Some valuable redistribution of the national income may have been effected, though even the large financial stimulus injected into American economy had at no time restored total national income to the 1929 level - attained, it is well to observe, after 9 successive and bulky Budget surpluses which had actually reduced the Federal Debt by \$ 9 billion. Otherwise, the Government expenditure aimed at economic welfare seems only to have lifted the general economy out of a morass, without reconditioning or steadying it. For the current year another heavy deficit - \$ 4 billion - is announced, which appears to be improving business once more. But is it not necessary to take into account both the financial (cumulative) effects of a regime deficitaire in the long run; and perhaps hardly less, the psychological influence on business confidence and sentiment generally?

Here there seems to be an appropriate field for careful inquiry.

7. Scrutiny of the economic implications of U. S. policy and of the working of economic cause and effect under its influence is rendered all the more appropriate if comparison is made with the action and experience of other countries.

In the U.K. confidence was wholly destroyed (in 1931) by the prospect of a heavy fiscal deficit; it was restored by the imposition of punitive taxation, whose effects were, at any rate at first, positively deflationary in their economic impact. Government relief expenditure was increased only to a moderate extent; agriculture and certain industries received subsidies; and the whole of this outlay had to be contained within the four corners of the Budget. No direct expenditure was engaged in, no enterprise undertaken by Government to provide employment for the workless. The basis of credit was greatly expanded, the cost of money reduced. confidence restored and the economic machine left to work out its own recovery. Two important factors assisted it, of course, at any rate in the short run:

1. The imposition of tariffs, affording a sudden- and one-time - stimulus to domestic production and enterprise;
2. The depreciation of sterling exchange.

The effect of the latter could, however, easily be overrated since it exerted a deflationary pressure on all countries outside the sterling group, thereby retarding world recovery.

By these methods unemployment was greatly reduced and a conspicuous recovery achieved. (In the personal opinion of the writer, unemployment in the U.K., though still at nominally 1,200,000, fell in the recovery to a point at which the residue of workless were, commercially and practically speaking, unemployables.) When at length the British Government embarked on special (re-armament) expenditure, financed by borrowing, the effects were almost wholly adverse. Industry being fully employed, the incursion of the Government caused a steep rise in prices followed inevitably by a sharp break in demand.

Here it will be interesting to see the further effects of Government expenditure now that (a) industry (in many sections) is not fully employed, and- (b) the advantages of both tariffs and exchange depreciation have worn off.

Thus the experience of Britain affords something in the nature of a negative offset to that of the U.S. recovery with little or no direct intervention (financially); and relapse despite the impact of Government expenditure on a more than negligible scale.

8. In Germany again, matters have been handled quite differently. Unemployment having assumed all the dimensions of a social and political disaster, direct employment-giving work was undertaken on a vast scale by the Government. Finance was provided by the creation of short-term debt and the expansion of the credit structure to support it. A rise in prices due to such expansion could not be prevented; but it has been arrested and a high measure of stability introduced into wages, salaries and prices. By the vigour with which the German Government re-started industry and other activity, through public works and re-armament, it has both unfrozen the banks and brought into operation a large "multiplier" in relation to its own direct expenditure. That is, the turnover and employment created by it have, in turn, stimulated and generated further trade and turnover, thus producing a large increase in total national income. On the other hand, the German Government has moved forward from a policy of apparent indiscriminate debt creation to one of very severe taxation - without so far producing harmful economic effects. In fact, the Budget may be described as "overbalanced". Less than half, perhaps, of the fiscal income is now required to cover current administrative expenses, the rest constituting a capital fund derived out of the taxable income of the nation. It would require too much time and space to deal at all fully with the methods employed by Germany, but it may be suggested that with, of course, important differences, they seem to combine the gigantic fiscal expenditure, in part applied directly to employment-giving work and enterprise, of the United States with the concentration upon fiscal equilibrium characteristic of the United Kingdom.

9. Both the expedients resorted to and the experience resulting from them are quite different in the case of France. Here there is the great difference that France is seldom beset with unemployment on anything like a dangerous scale. Following a line which is almost the direct opposite of that pursued in Germany and nearer perhaps to that of the United States, France has concentrated in various ways upon providing and re-distributing money income, whereas Germany has first and last emphasised the need for production as the "basis" of its economy. The implications of this striking contrast, extending also to the United States where large bonuses have been distributed with no countervailing production being called into existence (as in the case of France where production has been positively limited) are also worth comparative study and investigation.

10. Italy set its face from the outset against the distribution of the dole. But it has gone further in some ways than Germany in that apart from direct Government enterprise on a large scale, coupled with re-armament, it has subsidised large sections of industry. In the process and in the main unintentionally many of them have been reduced really to a no-cost-of-production basis. They can carry on only with constant Government support. Debt has been very freely created by the Government, without really securing prosperity for the national economy. Instead, the long succession of sharply deflationary measures has accompanied and contradicted the activating enterprise and expenditure engaged in by the Government. The

equipment of the country has improved out of all recognition, but is hardly on a commercial basis and is balanced - as it is to a lesser extent in Germany - by a decided decline in the standard of consumption or consumers well-being. In a word, the fact of large scale Government intervention in both these countries, though it has had the saving grace of banishing unemployment and re-gearing the capital goods and investment goods industries, has been very unbalanced from an economic point of view in the effects produced and the benefits conferred. Again, there is a difference between the two countries in that Germany, starting with a diminutive domestic national debt - (due to extinction of former debt through currency depreciation) is still in a very favoured position as regards the burden of debt charges; whereas Italy has accumulated not only indebtedness which must sooner or later become disquieting, but has so far, by inhibiting a noteworthy rise in the price level, allowed the real weight of such debt to remain very great.

This purports to be no more than a very rough and ready and cursory suggestion, covering some of the many aspects of Government finance and expenditure in relation to economic prosperity. Perhaps, if worked out in appropriate detail, the major questions at issue will be found to deserve deliberation and discussion.

---