

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 30, 1940To Chairman Eccles

Subject: _____

From Emile Despres

Mr. Currie asked me to go over a summary prepared by a member of the T.N.E.C. staff of the hearings on savings and investment before the T.N.E.C. last May. We have rewritten the introductory sections of the summary and suggested a number of revisions of the remainder. I have had to return the summary to Mr. Currie, and I don't think you will be interested in going over what I have prepared. I am sending it to you merely to keep you informed.

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SUMMARY OF THE HEARINGS ON SAVINGS AND INVESTMENT
PRESENTED BY THE SECURITIES AND EXCHANGE COMMISSION BEFORE THE
TEMPORARY NATIONAL ECONOMIC COMMITTEE
MAY 16-25, 1939

347

The process of saving and investment has been taken as the subject for this testimony because it is looked upon as being in a certain sense strategic for the operation of the economic system. President Roosevelt in a letter to Chairman O'Mahoney has written: "It is a matter of common knowledge that the dollars which the American people save each year are not yet finding their way back into productive enterprise in sufficient volume to keep our economic machine turning over at the rate required to bring about full employment. In the series of hearings which the Securities and Exchange Commission is to hold before this Committee, I take it that a major problem of your Committee will be to ascertain why a large part of our vast reservoir of money and savings have remained idle in stagnant pools." Before continuing with our summary it might be wise to explain exactly why and in what sense savings and investment are a major determinant of the flow of income.

It should be made clear at the outset that "investment" as used in this testimony does not mean the purchase of securities. Real investment occurs only when new goods not designed for current consumption -- plant, machinery, automobiles, etc. --

are brought into being. The purchase of already existing stocks and bonds may, to some degree, facilitate this process, while the purchase of newly issued securities certainly will, but no form of financial transaction is in itself investment as we are to understand the term.

The national income is generated by the outlay of individuals, corporations, and the agencies of government for new goods and services. Such outlays must, of course, represent either current consumption or investment. Since both consumption and investment stimulate income, and therefore employment, why is the latter considered to be of strategic importance?

Employment in the capital goods industries fluctuates far more widely than that in the industries producing goods for current consumption. The volume of current consumer outlay may be predicted with a fair degree of accuracy if the national income is known. It depends in the main upon income distribution and the tastes of individuals. Both these elements, of course, change over time, but the changes are likely to be continuous and of limited degree in any short period. They are affected irregularly by such things as stock market booms (as Mr. Currie's testimony indicated). They also may be consciously modified by government action. Nonetheless within limits they are predictable.

355

Outlays on capital equipment on the other hand vary with the anticipated opportunities for putting the new equipment to work. Thus they are influenced by such factors as the efficiency

of capital equipment, other technological conditions, the rate of population growth, the cost and availability of financing facilities, etc. This Committee has therefore set itself the task of examining the forces that determine this comparatively unpredictable factor of economic life.

For the purposes of discussion this general problem will be broken down into 10 specific questions.

1. What are the sources of the money used to purchase the annual output of goods and services?

2. How much of the national income is saved, and by whom?

3. Through what channels do individual savings flow? How are they used for the purchase of capital equipment? What is the function of the capital markets?

4. What happens to the savings of corporations? How much of the investment in plant and equipment is financed from internal sources rather than through the capital markets? What has been the trend in recent years?

5. What is the total volume of investment for the economy as a whole, and in what types of capital goods is it embodied?

6. Why is the rate of capital outlay declining? Are the causes temporary or permanent? Has the United States entered a more mature phase, in which a higher level of consumption may be necessary?

7. Was the great depression brought on by a decline in investment outlets? Was the recovery from 1933 to 1937 accompanied by an expansion of capital equipment?
8. How can opportunities for private capital expansion be strengthened?
9. How can opportunities for public investment be strengthened?
10. How can the proportion of the national income used for purposes of consumption be increased?

Let us turn to the consideration of these questions individually.

Where does the money come from?

The national income takes the form of a flow of goods and services. The money incomes paid out as wages, salaries, interest, and dividends, plus the accumulated profits of business (which may appear either as surplus or as earned but unexpended depreciation allowances), must be exactly equal to the total value of goods and services produced. Thus sufficient money income is always available to take off the market the entire stream of goods and services as it comes forward. It is available, but there is no guarantee that it will be used. If all recipients of income, whether corporations or individuals, immediately spent it again, the output of real goods and services would be sustained at a stable level. But some income receivers customarily decide to

withhold from current consumption expenditure a part of their income. (Corporations, of course, automatically withhold income from consumption whenever they accumulate surpluses or reserves.)

The national income, we have seen, is generated by consumption and investment. The lower the level of expenditures for consumer goods and services, therefore, the greater the volume of capital goods outlay necessary to maintain a given level of income. When individuals or corporations withhold funds from current consumption, they may themselves spend the same funds directly on investment goods. If this happens, no downward pressure is exerted on total income. Likewise, if at the same time that some income recipients are deciding to refrain from expenditures on consumptions, others are deciding to increase their capital expenditure concurrently by the same amount, no pressure is exerted on the national income. Since, however, decisions to save and decisions to invest are usually made independently and are seldom determined by the same considerations, they need not balance. When savers, at any level of national income, attempt to save more than investors are willing to invest, the national income must decrease until the unbalance is remedied. (For as incomes fall, the amount that income receivers find it possible or desirable to save is, of course, decreased.)

January 30, 1940

TESTIMONY BEFORE THE T.N.E.C.

Page 10, lines 15-18

"The funds available for investment" is not a measure of saving under any definition.

Page 10, lines 18-20

The wording of the sentence defining the second method gives the reader the impression that this quantity is something which might be called savings but really isn't. The second and third methods are not really distinct, and the wording of the sentence defining the third method might lead the reader to infer that offsets to saving are different from saving.

Page 10

This introductory paragraph should be replaced by a paragraph which states that (1) saving is income not spent on consumption, (2) since all money spent in the purchase of goods and services is received by the sellers of such goods and services, the nation's income, represented by wages and salaries, interest, rents, dividends and undistributed profits, is necessarily equal to the value of the national output of goods and services, and (3) the amount of income saved is therefore equal to the excess of the value of goods and services produced over goods and services taken off the market by consumers.

Page 11, line 5

The term "gross savings" should be used to denote savings plus depreciation charges. Gross national income should be defined as net income plus financial provision for depreciation. The sentence should read "in good times around 20 percent of the gross national income is represented by savings plus depreciation charges."

Page 11, lines 10-12

Dr. Currie's figures have been revised since the presentation of his testimony. On the basis of these revised figures, the ratio of offsets to savings to gross national income was 17.8 percent in 1937 and averaged 19.6 percent in 1923-29.

Page 11

Following the paragraph summarizing Dr. Currie's estimates, a paragraph should be inserted stating the factors which have operated to restrict the proportion of income spent on consumption during recent years. During the 1920's the growth in installment credit and the spending for current consumption of a part of stock market ^{gains}/caused consumption outlays to bulk larger in relation to income than would otherwise have been the case. During recent years the increased taxation of low incomes through social security taxes, sales taxes, and excise taxes has diverted to the state income which would otherwise have been spent for current consumption. As a result, the share of income devoted to current consumption was only slightly larger in 1937 than in the late Twenties even though per capita income was much smaller

in the later period. Unless taxes bearing upon consumption are substantially reduced and social security benefits increased, as large a volume of expenditures which offset saving will be required in order to achieve and maintain a national income of given size as was true in the past.

Page 12, lines 1-2

Corporations save from their current income, just as individuals do. Their savings take the form of surpluses, etc.

Page 13

Following the table, reference should be made to the fact that a large volume of debts have gone into default and have been written off, so that today's balance sheet data understate the volume of savings which have been embodied over the years in private and public obligations.

Savings are not invested in debts, but are merely represented by them. (It is difficult enough to establish the idea of investment as the purchase of new capital goods; the problem should not be complicated by using the word here in the old financial sense.)

Page 13, last sentence

It should be made clear that this statement refers to savings reaching the capital market through institutional channels, not to all savings.

Page 14, lines 17 and 18

In the late Twenties commercial loans were barely one-third of member bank loans and investments. Davenport's statement was that

commercial loans plus loans on securities were two-thirds of bank assets.

Page 15, line 4

Insert White's title: Superintendent of Banks of the State of New York.

Page 15, line 18

The portion of insurance premiums going to reserves can scarcely be classed as forced savings. Moreover, it is probable that most premiums are now paid under group insurance policies, which are term insurance and against which no reserves are accumulated.

Page 20, line 5

It is suggested that "increasingly have no use" be replaced by "have less and less need".

Page 22, lines 19 and 20

Don't these figures refer to outlays for replacement and improvement of plant and equipment?

Page 24

The table at the bottom of the page should be revised in accordance with Dr. Currie's revised figures.

Page 25, lines 2 and 3

Expenditures which offset savings are not "expenditures not for the purchase of goods".

Page 25, line 10

It is suggested that "cumulative" or "multiplying" be substituted for "flywheel".

Page 25, line 14

Change "capital" to "income-generating".

Page 25, table

Change "Foreign Balances" to "Foreign Assets". Change "Private Plant" to "Private Plant and Equipment". Change "Government Plant". Currie's figures refer roughly to Government outlays financed by borrowing.

Page 26, line 1

It is suggested that "and healthy" be omitted.

Page 26, line 8

Is the implication that Government outlays are not solid investment intentional?

Page 26, lines 8-13

In an expanding economy, inventories and installment financing could go on increasing indefinitely, but not at the rate of 1936 and 1937. Neither could private capital outlays continue at the rate of the late Twenties without a much larger volume of consumption expenditure than then prevailed. From 1931-33, inventories did decline and so did consumer credit, but net capital outlays for plant and equipment were also negative; i.e., new expenditure fell below depreciation charges.

Page 26, line 17

The ratio as revised was somewhat lower than in the Twenties. It may not be sufficient to spend 19 percent of our income on capital

outlays to prevent the national income from collapsing; 19 percent of a low national income would be a low volume of capital outlays, and would not necessarily provide any stimulus to higher national income. Moreover, no account is taken of the possibility of raising the proportion of income consumed. This would both reduce the need for capital outlays, and increase the stimulus to such outlays. This point is neglected throughout the summary.

Page 31

A paragraph should be inserted at the close of this section pointing out that the closing of the old frontiers for extensive expansion automatically opens up new frontiers for intensive expansion and that we can now, if we will, make the transition to an economy of abundance, resting upon more adequate consumer purchasing power. It is only because of the existing pattern of income distribution that a high volume of capital outlays is required to sustain full employment. If we can divert more income from saving to consumption, we shall not only have full employment but shall be devoting a larger proportion of our huge productive power to improving current well being. The shrinkage of investment outlets need not be pessimistically interpreted. It means that we can reap the harvest made possible by past accumulation.

Page 32, lines 3-6

The merchandise export surplus does not reflect our net capital export. Our balance in merchandise and services, which does reflect capital export, was considerably below 10 billion dollars.

Page 33, lines 10 and 11

Savings did not accumulate at substantially their old rate. The shrinkage in investment outlays induced a contraction in national income to a point where savings were brought down to conform to the curtailment in investment outlets.

Page 34, lines 10-16

It should be explicitly stated that these figures rest on the assumption that the proportion of income saved under prosperous conditions will be the same as in the 1920's. The possibility of reducing this proportion through Government policies should always be mentioned.

Page 35, table

This table omits (1) net exports of goods and services, (2) inventories, (3) consumer credit.

Page 36, last paragraph to Page 37, line 10

This is highly controversial and is not a part of the record, so far as I can observe.

Pages 44-46

Strengthen.