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February 22, 1950

SPECIAL MEMO FOR
Mr. Marriner S. Eccles

Dear Sir:

The enclosed copy of my Demurrer to the *Report on "Federal Expenditures and Revenue Policy for Economic Stability" by the Princeton Panel of fourteen eminent University Economists, may be of some interest to you since the recent publication of the fourth annual Report of the Council of Economic Advisers.

You doubtless noted in Mr. Keyserling's Report, his frank adoption of "Communism, Socialism, and the American System". This is, I believe, the first official recognition of the existence of "three principal systems or schools of thought" in economics and establishes the tripartite concept to replace the former generally held monistic theory. Mr. Keyserling is to be congratulated on making many notable advances since his prize-winning thesis in the Pabst competition in 1944.

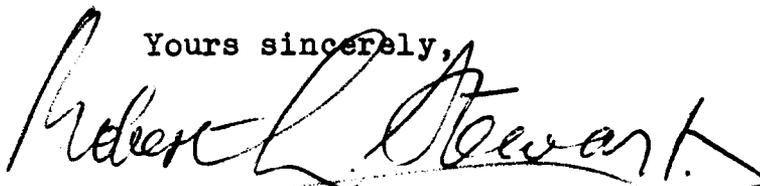
In this connection I would cite a paragraph from Mr. Frank Altschul's NFA pamphlet #69:

"We must be willing to re-examine the most trusted economic theories of the past in order to determine whether they furnish sure guides to conduct today."

--otherwise there is extreme danger in college classrooms of unwittingly conditioning and predispositioning the minds of our coming business men toward Socialistic schemes and propaganda.

I am hoping that definite responses to the final paragraphs of the Demurrer now will be forthcoming lest its enemies charge that the American System today seems to be in the hands of citizens who are generally capable but who appear to be partially blind in the economics spectrum.

Yours sincerely,



*Copies of the Report of Hearing held September 23, 1949 on "Federal Expenditure and Revenue Policies" (#96773) may be had from the Joint Committee on the Economic Report, Senate Post Office, Washington, D.C.

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November 29, 1949

Senator Paul H. Douglas,
Senate Office Building,
Washington, D.C.

My dear Senator Douglas: NPA Report on "Federal Expenditures and
Revenue Policy for Economic Stability."

I understand you are prepared to receive for consideration from me a Demurrer to this Report, prepared by a Panel of fourteen eminent university economists under the auspices of the National Planning Association, of which I am a member.

I therefore offer a general summary of observations and append a brief discussion of important phases of the Report by way of support and amplification:

1. The central proposal of the Report appears to be a matter of taking hold of a very large bull by a set of very large and complex horns! The bull is our old friend the Business Cycle. The Panel proposes that the Government shall undertake to control the movements of the Business Cycle by means of "counter-cyclical fiscal action".

To students of the Business Cycle this sounds very much like optimistic idealism of a very high order. Can it be possible that the Panel assumes that your Committee is entirely oblivious of certain very pertinent facts concerning the situation:

that the Government cannot exercise
foresight;
that in economics, its prophets are
generally unreliable;
that it can act only after the event; and
that all large bodies are known to move
slowly - very slowly.

2. In any event it seems certain, if for no other reason, that "counter-cyclical fiscal action" will fail because, as outlined, it deals entirely with the "effects" instead of with the underlying "causes" that threaten economic stability.

3. "Counter-cyclical fiscal action" as proposed includes tax manipulation and Government spending to relieve unemployment. Against these measures it can be successfully argued that nothing in economic history can be cited to show that either of them ever has contributed anything to economic stability. Also if the Government should initiate spending policies to distribute purchasing power so as to relieve any large measure of unemployment, this in all probability would start a deflation snowball rolling that might quickly drive the Government out of office.

There is also the proposal to start large scale public works to aid in re-establishing economic stability. On account of ever-increasing mechanization the effectiveness of this measure is now open to serious question. Construction works, and I speak with considerable experience, are not susceptible to prompt starts and stops without serious economic loss. In addition it is difficult to make good road builders out of CIO auto factory workers; and mass migrations and large scale work changes are possible only under conditions familiarly associated with the Soviet Union.

4. I believe it is imperative to inquire how it is possible to formulate proposals for economic stability without first precisely defining the term "inflation", as wide differences of opinion exist as to its import and applications.

5. The foregoing seems to point to the conclusion that the resources of the science of economics, as presently constituted, are inadequate to cope with all the practical problems that arise in connection with economic stability. A more comprehensive viewpoint seems to be necessary. It may be possible that experts in the field of coordinating Management might be of help to the "hard pressed legislators". One of the first steps might be the appointment of a Commission to make recommendations as to a fixed equitable proportion of the total national income that should be spent by the Government.

DISCUSSION

The Report recalls to mind the report on exactly the same subject by the Committee for Economic Development issued in December 1948. It may be noted incidentally that five members of the Research and Policy Committee CED are members of the Board of Trustees NPA and that Dr. Jacob Viner, Past President of the American Economic Association, is on the Research Advisory Board CED and is one of the members of the Princeton panel; also that Professor Sumner H. Slichter had reservations regarding the latter section of the Report.

It is therefore rather startling to find that the recommendations regarding taxation in the NPA report are a complete reversal of those in the CED report.

In the CED report, page 36, the recommendations for the first order of business in both inflation and deflation is precisely to "Hold taxes stable" which of course means "Do nothing with taxes." Whereas the whole tenor of the proposals in the new NPA report emphasizes the policy "Do almost everything with taxes." The fact remains, however, that taxes are a headache and not a universal cure-all.

If, however, it is assumed that the Government by using its power of tax manipulation actually can ensure economic stability and that a reduction in taxes can increase employment, in accordance with the NPA premise, then the fallacious conclusion that taxation is the prime cause of unemployment, seems inevitable. In this connection it is disclosed, page 6 (Report of Hearing) that taxes are now nearly 25% of the gross national product. This indicates that the industrial dog has a 25% "tax" tail and that it is fervently hoped and expected this monstrous tail will somehow find a way to wag the 75% dog!

It is stated, page 6, that "tax collections tend . . . to lower prices." This surely requires some explanation regardless of whether the word "lower" should be taken as a verb or an adjective. If high taxes can make low prices, every industrialist in the country will welcome the information.

Probably the most challenging innovation is on page 6. There we read "Annual budget balancing is, thus, both difficult and unsound in principle." Every controller and CPA in the country will be struck by the implications of this statement. If an annual balance sheet is a "must" with our largest corporations, why not with the Government?

One of the reasons given for abandoning annual budget-balancing is that instead of a year, the period should be the "full span of the business cycle." Theoretically this span is supposed to be from 3 to 5 years but experts seem to agree that the typical cycle is much shorter, and no means have been discovered for determining just what it actually will be. So the question arises why introduce an unnecessary factor of indefiniteness into the proposals which is certain to cause discord and confusion?

It must however be noted that the science of economics is now inextricably bound up with and qualified by possibly a dozen other sciences of front rank importance, such as management, banking, law, politics, insurance, accounting, taxes, production, sales, etc., and without the advice and cooperation of experts in these highly technical fields, policy pronouncements by economists are apt to be merely unilateral statements that may easily be misleading and often dangerous.

On page 8 we are introduced to "automatic flexibility" in fiscal policy. This is defined as "a tax system such that revenue under a given set of tax rules will fall sharply if unemployment develops". By "unemployment" is presumably meant a total unemployment figure of 5,000,000 persons. Whether it be this figure or some other, and whether there be "automatic flexibility" or not, it seems to be

axiomatic that when there is a marked drop in employment, tax revenue will also drop under any tax system that will not be held unconstitutional by the U. S. Supreme Court.

In general terms it may be agreed that economic stability means the elimination of the violent swings of the business cycle. However after a quarter century of intensive investigation and research, it is now pretty generally conceded that the business cycle is absolutely unpredictable and has the appearance of being erratic and irrational. Some people even seem to feel that the swings of the cycles most probably are in the hands of fickle and inexorable Fate! This apparently has forced upon many honest and well-intentioned minds the idea that if this country is to be preserved from extermination by chain reactions that might arise from a particularly violent swing of the business cycle, it is imperative that all major economic controls be promptly vested in the Government.

Traces of this trend of thought are to be found in various places in the report. On page 8 for example, it is stated that "Government must not shirk the responsibility". On page 8 there is the remark that "Legislative process is necessarily too cumbersome". On page 9 is the call for "granting to the Executive wider discretionary authority". And finally on page 6 is the previously mentioned plea for abolishing the annual budget-balancing and for introducing certain "flexibilities" that would be governed by the discretion of the Executive. It is evident that all this adds up to a recommendation for a further turn to the left and is a preliminary to the introduction of a policy that inevitably would place the country firmly in the hands of a Socialist regime.

The undisclosed reason back of this appears to be that giving the Government maximum control of the economy is thought to be somehow the only way to get some kind of a national economic cyclone cellar for use when the fury of the winds of depression threatens to destroy us. This on analysis will be found to be a futile and forlorn hope based on wishful thinking.

Furthermore newspaper writers have found that the words "Socialism" and "Socialist" have now lost most of their kick as scare headline material. The truth is that due to various insidious and sometimes largely unconscious efforts, Socialist ideas are now accorded a certain tolerance in the minds of average citizens. What is not so generally known is that the claim that a Socialist government for this country is inevitable, can be completely and rationally refuted.

Briefly summarized, the difficulty in the past has been that economists have largely been engaged in viewing the economy piecemeal and in detail. What is needed is a more comprehensive view of the economic organism as a complete and operating whole. In addition, the call today is not only for "economic stability" but for rational and consistent progress in all constructive phases of economic life. The reason for this is that a stable and static condition implies death and dissolution.

In this view the idea emerges that all spending by Government -- payrolls and purchasing -- is a liability, for it takes over, through taxation, the "new money" from the productive units and spends or dissipates it -- "sinks it without leaving a trace," if you please. When the Government spends more than the amount of "new money" taxed from the productive units, it is in the "red" or in a state of imbalance. This country can adjust to a greater imbalance than any other, but there is a limit beyond which lies disaster.

A vital factor in viewing the economy as a whole is the importance placed upon what is known as "production" or the gross national product of the economists. This production, or turnover, is relatively secondary. What is of prime and paramount importance is the "net" -- the "new money" which is produced and is the excess of the income over the outgo. In the 1930's we had the peculiar phrase "profitless prosperity". This is now seen to be economic fiction and a gross contradiction in terms. When the primary emphasis is upon net income instead of upon gross production, the entire economic situation is re-oriented and transformed. Instead of mere mechanical multiplication of output, we create the opportunity for the introduction of all the finesse, genius, and proficiency that is included under the potent term "American Management".

On the other hand, the Government, unless it attempts to invade Industry, cannot produce a cent of "new money". It is a spending agency pure and simple. The Government operates exclusively by orders and directives issued by the "top brass" which requires the setting up of rigid routines and standard practices. This is the cause of the monumental and incredible loss and waste that are associated with all governmental operations. When it is suggested that "flexibility" can be introduced into these operations this is a call for Management; but in Government, Management is relatively non-existent and unknown.

Management belongs essentially in Industry and provides the competitive individual means for insuring that income shall be in excess of outgo, a condition which has no parallel in Government. Thus the whole genius of Industry is to so spend a dollar that it returns like the Australian boomerang to its spender, with a little profit-dime attached. But when Government spends a dollar, it remains spent!

It may be argued that certain governmental operations save money for the public and "money saved is money gained". The only items that can be reckoned as actual savings in governmental operations are those which directly reduce costs for the producing units. All other savings are in general only "deferred spending". Under no circumstances can they be classified as "spending for production".

It is evident from this that the proposal to defeat deflation and unemployment by government spending amounts to an attempt to extinguish a fire by pouring oil on it. It creates greater imbalance, hence still greater inflation.

As a matter of economic and political policy, the size of the

Government payroll is of increasing importance. The "security" it affords constitutes a constant and perhaps irresistible attraction for many citizens. But every worker who transfers from the payroll of a productive unit to a Government payroll adds a double burden to the economy. And the greater the number on Government payrolls, the greater the danger of psychological imbalance and panic, particularly when resort is had to the deficit financing, which is not considered any hazard for a Socialist regime.

It is tacitly implied in many quarters that economics is a complete and unitary science with a philosophy that has worldwide and universal applications. The fact is that it embraces three principal systems or schools of thought which apply specifically to certain definite geographical and political areas. There is the British system, exemplifying the economics of Socialism from Adam Smith to Lord Keynes; the Soviet system, presenting the economics of Marx and Lenin; and the American system featuring the economics of Management under the free enterprise system.

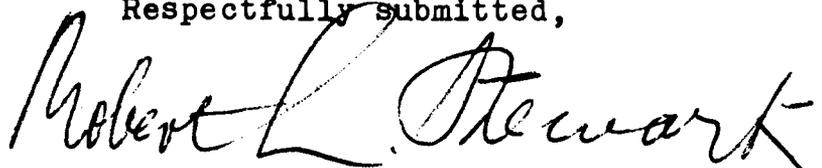
The principles, concepts, and formulas of each of these systems are native, peculiar, and non-transferable; and the utmost confusion and dislocation occurs when attempts are made to impose those of one system upon any of the others.

As a preliminary to the consideration of a policy that will insure both economic stability and continuous progress, may I suggest that the eminent panel of economists consider why this country has achieved 99-44/100% economic self-sufficiency and how it is able and willing to bail out nearly all the bankrupt national economies of the world including those of most of its former competitors.

This inevitably leads to the question of profits. What is the basis of profits and how are they produced under our American System? There is much confusion of thought on this subject.

The next consideration is the apparently limitless possibilities of industrial production in this country. Coupled with this is the baffling anomaly of producing better goods while increasing wages at intervals and constantly reducing costs and selling prices. This is the American system operating at full blast right before our eyes. How is it done, gentlemen?

Respectfully submitted,



RLS/cmp

SUPPLEMENTARY NOTE:

Fiscal policy, in principle and under the European tradition, is the last mainstay of the capitalist class whose one interest is the interest rate. Under the American System, fiscal policy can have only a psychological effect upon the producing units, and this would be of negligible significance.

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December 26, 1949

Mr. David Lawrence,
U.S. NEWS & WORLD REPORT,
24th & N Streets, N.W.,
Washington 7, D.C.

Dear Mr. Lawrence:

The statement, "Civilian Control or Militarism" by the Research and Policy Committee, CED, in your issue of December 23, raises by indirection a fundamental issue.

I quote the Preamble of a most important document:

"We, the people of the United States, in order to form a more perfect Union, establish Justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity, do ordain and establish this Constitution of the United States of America."

A reading of this makes it clear that the CED in effect charges, and presents detailed evidence to prove, that the Constitution has become endangered and is threatened with annulment.

Let it be stated, however, that when the provisions of Articles 1, 2, and 3, and their legal implications, are fully recognized and enforced, this country is completely equipped to resist all attempts to make changes in the fundamental character of the government and the institutions established under the Constitution.

Why then has the CED found it necessary to sound the alarm? Because, possibly, of the basic tendency of the military authority - the "Soldier" - to become a law unto itself and thus as a matter of principle to recognize only policy and rules of its own making.

This, it should be noted, is also the standard procedure of the present-day Communists. They have demonstrated that when the "Soldier" and the "Political Policeman" combine forces there is, in all countries except the U.S., little to prevent the establishment of the "garrison-police state."

Why the proviso "in all countries except the U.S."? Because here we have demonstrated (in industry) that we possess

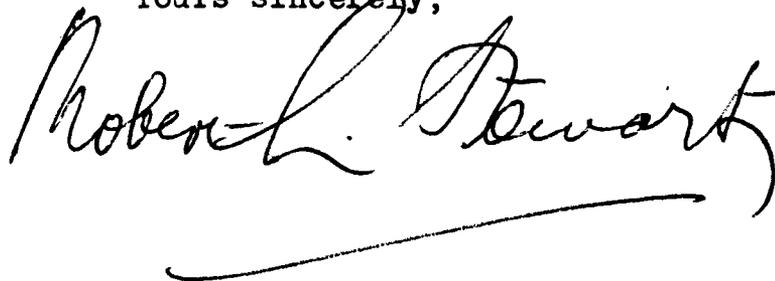
powers of inestimable value that have permanently secured for us national economic self-sufficiency - and probably much more. We have removed economics from the realm of the academic and given it power and authenticity in the world of production. More specifically - and these are exclusive features of our American System - we have devised efficient means:

1. To ensure profitable performance under perpetually changing conditions.
2. To bring true coordination into management and so deliver it from the terrific loss and waste that has been inevitable under the rigid "line and staff" system adopted from the military code.
3. To definitely cope with the Law of Diminishing Returns.

Both the "Soldier" and the "Political Policeman" seem, to date, to be completely oblivious of the existence of these saving graces and to this may be attributed all the excesses and blind blundering for which they have been responsible for as long as anyone can remember.

I submit that the Constitution is still valid, potent, and completely effective and that the only danger is that intelligent people may be so blind to the real situation that they can be propagandized into panic and despair and thus be conditioned for trading the real security of the Constitution for the vain promises of the ambitious promoters of the "garrison-police state".

Yours sincerely,

A handwritten signature in cursive script that reads "Robert L. Stewart". The signature is written in black ink and is positioned below the typed name. A long, horizontal flourish extends from the bottom of the signature.

RLS/cmp