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Draft

CAUSES OF THE DEPRESSION

In attempting to throw light upon this extraordinarily difficult subject it is helpful to limit the scope of our inquiry by drawing certain distinctions. The first distinction we should draw is that of necessary conditions and essential causes. An example of a necessary condition is the existence of that economic organization of society known as capitalism. Doubtless economic activity in a barter economy or a communist society would experience certain fluctuations but the business cycle as we know it appears to be related to capitalist economies. Yet it is obviously not helpful to say that the cause of the depression was capitalism. Capitalism, in other words, was a necessary condition for the depression, but it was not the essential cause. It is proposed to limit the investigation to those particular factors operating within a capitalistic economy which appear to be <u>directly</u> and <u>immediately</u> associated with the particular downturn that started in 1929.

This may appear to be a superficial approach; yet a moment's reflection will convince the reader that it is the most fruitful one. For instance, it is often said that the war was the cause of the depression. In the sense that every event is dependent upon every event that preceded it, the war was a necessary link in the chain of developments that led to the depression, but it was only one link in a chain that stretches back to the beginning of time. Countless things happened both before and after the war which were equally essential to the development of the depression. If, therefore, we are not to become lost in the hopeless complexity of inter-acting "causes and effects" or, more properly, "sequences" we must limit our inquiry to the developments or sequences immediately prior to the downturn.

The second distinction that should be drawn is between possible and probable causes of the depression. There are an infinite number of things that could bring about a depression. Many of the manifold particular theories of the business cycle are logically consistent. They stress one factor which, assuming a given pattern of other factors, could bring about a downturn. Most of them contribute to our understanding of the inter-relationships of economic variables. We must not, however, make the mistake of assuming, as business cycle theorists so frequently do, a given pattern of factors other than the one under consideration. In other words, when we attempt to disentangle the approximate causes of this depression we are dealing with a particular and not a general problem. We should seek as far as possible to improve our understanding of the inter-relationships of economic variables, but in addition and equally important for our purposes, we must try to ascertain the relative magnitude of the variables in the period immediately preceding the downturn. Our concern is with probable rather than possible causes.

Finally, it is necessary to distinguish between probable factors that led to the initial downturn and those factors which intensified and aggravated the downturn after it had once started. In part it appears likely that the same factors were involved in both cases, but in large part they were different.

As an approach to the problem it may perhaps be helpful to try to get a broad picture of the nature of the period following the post-war boom and depression, and ending with 1929.

1. It was a period of exceptionally rapid growth. Professor F. C. Mills, who has analyzed this period more exhaustively than anyone else, concluded that "relatively to the basic needs of the population the volume of goods of all sorts produced in the United States was being increased between 1922 and 1929 at a rate probably never before maintained for a similar period of time", (Economic Tendencies, p. 530). Professor Morris A. Copeland estimates that the national income increased at the rate of 3.8% between 1923 and 1929.

2. The proportion of the national income going to workers and to property owners remained constant, or in other words, workers received as great a proportion of the increase in the national income as they received of the national income at the beginning of the period.

NATIONAL INCOME BY TYPES OF PAYMENT, 1923-1930

	Percentage of the National Income Going to Employees				Proportion going to Ownership			
	(1) Copeland	(2) King	(3) Dept. of Commerce	(4) Leven	Copeland	King	Commerce	Leven
1923	70.5	61.9		-62.7	29.5	38.1		37.3
1924	69.6	61.9		63.6	30.4	38.1		36.4
1925	69.0	61.2		61.7	31.0	38.8		38.3
1926	69.0	p62.0		63.8	31.0	p38.0		36.2
1927	68.4	p61.9		64.6	31.6	p38.1		35.4
1928	68.7	p60.8		63.5	31.3	p39.2		36.5
1929	69.0		64.0	65.1	31.0		36.0	34.9
1930	p67.8		63.9		p32.2		36.1	
1931			64.3				35.7	
1932			63.4				36.6	
1933			62.6				37.4	

(1) Journal of Political Economy, December, 1932, p. 787. Income of non-agricultural employees as a percentage of non-agricultural income.

(2) The National Income and its Purchasing Power, p. 74. Income of employees as a percentage of realized money income

(3) Mimeographed release, The National Income, 1933, p. 7. Salaries, wages, compensation and pensions as a percentage of income paid out.

(4) America's Capacity to Consume, p. 158, Income of employees as a percentage of income produced.

3. The period was one in which the productivity of factory workers increased rapidly and yet the demand for the products of factories increased sufficiently so that no net displacement of workers took place. The average numbers of wage earners as given by the census were: 1923 -8,776,646; 1929 - 8,808,000.

4. Commodity prices were remarkably stable throughout the period 1923-29, though on the whole tending gently downward in the latter part of the period.

5. Inventories. Available data indicate no excessive accummulation of inventories in this period. Kuznets estimates that from 1923 to 1929 the increase in inventories (by value) amounted to 56% of the increase in the total flow of all finished commodities. This is slightly below the average ratio of inventories to flow of finished commodities for the period 1919-1932.

6. Profits of all corporations increased along with the increase in invested capital, so that there is some evidence that the rate of return on invested capital in industry as a whole fluctuated very little throughout the period. According to the calculations of Nerlove, the rate of return on invested capital was as follows:

1923	1924	1925	1926	1927	1928	1929
7.5	6.4	8.3	7.9	6.8	7.9	7.7

7. The output and profits of the larger publicly-owned corporations increased relatively to the smaller privately owned corporations and businesses. The popular idea of "profit inflation" in this period is partly traceable to the common practice of generalizing on the basis of a selected group of companies listed on the stock exchange.

8. The supply of money from 1923 to 1929 increased at the rate of 2.6 percent per annum, while the national income, according to Copeland, increased at the rate of 3.8 percent per annum.

9. It is sometimes asserted that one of the forces sustaining the demand for our products in this period was our large and continuous loans abroad. According to the published figures, however, our net export of capital in this period fell considerably short of our net interest and dividend receipts from abroad.

On the other hand, there are many who appear to believe that because of our tariff policy foreigners could not meet their interest obligations to this country in goods, and hence had to send us gold, but in the period 1923-29 we received from abroad a net amount of only 173 million dollars in gold (net gold imports plus net release from earmark). In other words, our debit and credit items other than gold over the entire period approximately balanced.

10. It is sometimes said that one of the abnormal features of the period under discussion was the unprecedented building "boom". Available figures do not permit comparison with other periods. It is, however, possible to obtain some perspective on this subject by comparing the annual reported value of new residential construction with the national money income. The percentages of the former to the latter for the years 1925-29 are as follows:

1925	1926	1927	1928	1929
4.1	3.8	3.5	3.7	2.4

The inclusion of non-reported building would raise the percentages only slightly and would probably not affect the trend. These percentages indicate that a comparatively small proportion of the national income was devoted to new housing accommodation. When it is considered that (a) the demand for housing accommodation arises both out of increased population and increased income, and (b) that the existing stock of houses is steadily depreciating, the amount of residential building in the years in question does not appear to be excessive in the sense that it could not reasonably have been maintained or increased. There are indications that rents were falling, but the data on rents, building costs, and carrying costs are too faulty to permit of reliable inferences on the basis of small movements of these series.

11. Construction and addition to capital. Kuznet's estimates of total construction, in billions, and these estimates expressed as percentages of total money income, are as follows:

	1923	1924	1925	1926	1927	1928	1929
Total Construction	13.3	13.3	14.0	14.3	14.9	15.9	14.4
Percent of Income	19.3%	18.9%	18.8%	18.1%	18.4%	19.1%	16.6%

Total construction includes the bulk of the additions of all kinds to the capital equipment of the community, although it should be noted that it does not necessarily represent the net addition. It will be observed that from 1923 to 1928 total construction amounted to about 19% of the annual money income, a sharp fall occurring in 1929.

Kuznets also presents interesting tentative figures on the formation of net capital destined for business use. These figures are arrived at by deducting from gross capital for business use, parts, repairs, maintenance of construction, changes in inventories, depreciation and depletion. Figures are in billions of dollars.

	1925	1926	1927	1928	1929
Net addition to business capital	$4.4	$4.7	$4.4	$4.6	$5.6
Percent of national income	5.9%	6.0%	5.4%	5.5%	6.4%

These figures indicate that the net additions to business capital are surprisingly small in relation to the national income. They also indicate that the proportion remained comparatively stable throughout the period. The figures give no support to the contention that the inequality of incomes was resulting in a continuously larger proporti n of national income being devoted to additions to our productive facilities.

The above figures also indicate, by inference and in conjunction with other data, that the proportion of the national income spent on consumers' goods and services remained stable between 1923 and 1928.

12. Estimates of agricultural income are as follows:

	Gross (millions)	Balance after operating expenses available for owner's capital labor and management. (Millions)	Income per farm. (dollars)
1924	11,337	5,844	862
1925	11,968	6,229	903
1926	11,480	5,941	874
1927	11,616	6,278	880
1928	11,741	6,278	866
1929	11,911	6,332	887

13. Stock prices in relation to earnings. See attached note.

14. Interest rates.

I have to this point presented various economic series for the period 1923-1929. The composite picture resulting from these various series is one that may be broadly characterized, I think, as economic balance. It was,in other words, a period of rapid change and growth under conditions of general stability. The downturn from such conditions is obviously much more difficult to explain than would be a downturn from an obvious boom with rapidly rising prices, speculative inventory buying and other factors of a highly unstable and temporary nature. It is my view that the causes of the initial downturn must be sought in certain developments peculiar to the years 1928-1929, and that the cause of the intensity of the depression must be sought in specific developments in 1930-1932 that reacted upon a system that had lost its capacity to adjust costs of all kinds smoothly to a restricted demand. I dissent sharply, largely on the basis of the data quoted above, from the current idea that the whole 1923-29 period was a highly abnormal and unstable one sustained by one or two big factors that were temporary in nature. Consequently, I also dissent from the corollary view that the remedial action of the Reserve Administration in 1923-24 merely served to postpone the collapse which was inevitable and which was bound to be worse the longer it was prolonged.