

(First Revision)

9/26/38

Compensatory Fiscal Policy

I

The competitive capitalist system under democratic political forms has come upon evil days.

In spite of increased aggregate production and much larger potential production, we have acute unemployment, acute shortages of material goods for many persons; and, more important, we lack a feeling of security upon which the building of a good life depends.

II

The magnitude of surface symptoms suggests that the causes of our difficulties must be fundamental. Measures to be constructive must be correspondingly fundamental.

III

Among several important causes, one clearly seems to be that the relation between purchasing power and production has been incompletely understood, and, accordingly, the role of the national state in relation to purchasing power and production has been erroneously conceived.

Although this misunderstanding has been general and has existed for a long time, an acute condition has only recently appeared. That it has been so long deferred is due to the fact that until recently governments have been converting national assets (the national domain) into purchasing power. This purchasing power, supplementing that arising directly from production, has mitigated somewhat the deplorable conditions which have existed since the industrial revolution.

IV

The conception of the role of the national state (whether democratic or totalitarian), in relation to purchasing power and

production, is undergoing profound change. This change is based on two separate but related considerations:

1. The operation of a private, competitive, capitalist system, based in part on private debt (credit) involves necessarily from time to time increases and decreases in aggregate purchasing power with no corresponding increase or decrease in potential production. The consequence is unemployment and distorted price relationships that are morally and politically destructive. Therefore, for these changes in aggregate purchasing power, (arising from the very nature of private enterprise), the national state must compensate in the management of its budget, or otherwise.

2. The effect of the application of science and technology to production is to increase potential production. This increase in potential production does not of itself insure either (a) that there will be corresponding increase of purchasing power, or (b) if there be such increase in purchasing power, that it will be spent on consumption, or invested, in new plant. Unless and until the increase in potential production results in increased purchasing power, and this increased purchasing power spent on consumption or invested in new plant, the result will be unemployment, and partially idle plant. Accordingly, to insure full production, the national state must be prepared to insure the necessary purchasing power through the management of its budget, or otherwise.

In summary, a private, competitive, capitalist system with progressive technological improvement requires on the part of the national state deliberate action of a compensatory character af-

V

The necessary compensatory action is most readily taken by the national state through the management of the national budget.

Compensatory management of the national budget requires correlation of policy in handling all national measures affecting money, credit, taxation, and expenditure.

VI

The principle of the compensatory budget requires an important extension of the common concept of the function of taxation.

The compensatory effect of the budget is produced, not by the absolute level of income or expenditure per se, but by the magnitude (and method of obtaining) the net cash deficit or surplus. This deficit or surplus may be altered either by changes in disbursements or by changes in receipts.

It follows therefore that taxation, in providing revenues to the national state, concurrently gives one method of controlling the size of the deficit or surplus. That is to say, taxation provides a mechanism whereby purchasing (and investing) power in private hands can be reduced or increased in amounts and in a manner conforming to general public policy.

It follows similarly that the expenditures and disbursements of the national state, in providing for the common services, concurrently gives another method of controlling the size of the deficit or surplus. That is to say, expenditures and disbursements provide a mechanism whereby purchasing and investing power in private hands can be increased or decreased in amounts and in a manner conforming to general public policy.

VII

A number of questions of public policy are involved in the administration of a compensatory budget.

1. What should be the absolute level of income and disbursement about which variations take place?
2. What should be the magnitude of the deficit or surplus at any particular time, and what agency should make this determination?
3. Shall the operation be applied to expenditure, or to income, or to both, and to what degree?
4. Shall the direction of increased (or reduced) purchasing power be toward producers, or toward consumers, or toward both, and to what degree? If toward producers, which? If toward consumers, which?

VIII

The importance of the policy questions raised above may be judged by relating the gravity of the present position to the magnitude of current production possibilities.

We can produce annually with reasonably full employment, ninety billion dollars worth of goods and services; we are in fact producing slightly more than sixty. A current deficiency of production and of purchasing power of about thirty billion dollars annually is indicated.

If we allow for expenditure or investment to turn three times a year, in order to raise purchasing power thirty billion dollars, ten billion dollars in the aggregate would need to be added to current levels by public and private enterprise to secure reasonably full employment and production.

Private enterprise can hardly add more than at the rate of four billion per year this year. Even this figure assumes high activity for housing, utilities, railroads, and industrial investment. This leaves at least six billion dollars per year of production that the federal government has available to work with this year, this being at this time the indicated appropriate deficiency of net (cash) disbursements over income on whatever absolute level.

The adoption of a compensatory budget policy raises certain difficulties and dangers.

1. The problem of timing is a difficult one at best. Existing mechanisms for expenditure and for taxation were not devised with such policy in mind and are clumsy for the purpose.

2. Bottle necks will develop. They will disappear. Foresight will reduce their number and severity.

3. Unless a reasonable degree of competition is maintained, there is likelihood that the great benefits of full production will go to organized groups best able to take toll on increased purchasing power.

4. Strikes and lockouts, reducing production, might defeat the program.

5. Over-emphasis on fiscal policy, particularly in its initial successful phases, might cause neglect of other measures necessary and proper for satisfactory restoration of private employment.

6. Public misunderstanding may result in loss of confidence. The implications of the policy are so foreign to conventional ideas, and to ideals of private prudence, that great resistance of both an intellectual and moral nature will be encountered.

7. The most serious danger is that of congressional interference with budget planning, of over-appropriating and under-taxing on a purely political basis. We do not have the tradition of an executive budget as in England. We need the item veto provision badly. The proposed Fiscal Advisory Board will be a protection as it develops prestige. The dangers here, though very real, must be faced and risked for the sake of the benefits that may result.

X

Although a number of measures are desirable to secure the benefits which seem attainable, among these measures the adoption and administration of a compensatory budget policy is indispensable. The benefits to be gained are very great. These are:

1. Reasonably full employment, an increase of about 50% in production and therefore in the material standard of life. There would be a marked increase in the consumption of agricultural products.

2. Elimination of wide swings in employment and production would have a marked influence on the stability of employment. No insurance scheme, though necessary, can substitute for security itself.

3. Fuller use of industrial and agricultural overhead will result in a reduction of average costs. The saving will be divided between profit, wages, and lower prices.

4. With reasonably full employment, adequate purchasing power, and near capacity production, many problems now appearing to call for government intervention or control might solve themselves. In other words, the assuming of control by the national state (the authority for which is generally conceded) over monetary and central fiscal policy in this manner would lessen the demand and need for central

government control in other parts of the economy.

5. An opportunity is provided to direct the first fruits of this increased production into socially useful channels, such as public health, education, old age security, slum clearance, etc.

6. In time it would be possible to restore to employment many young people, many older people, and many women. Not only would their contribution in production be of great importance, but present enforced leisure is demoralizing to individuals and to the community.

7. Reasonably full employment and production would simplify the problem of American attitude toward foreign trade. We are in a position to receive goods and services from abroad on balance for a long time if we can organize to receive them. This, of course, would contribute to friendly international commercial relations.

Beardsley Ruml

September 26, 1938

ESTIMATED EXPENDITURES FOR NEW DURABLE GOODS, IN CURRENT DOLLARS
(Millions of Dollars)

	Totals				Producers'								Consumers'		
	All goods covered	Producers	Consumers	Public	Railroads	Electric power	Telephone	Transit	Other utilities	Mining and manufact.	Commercial bldgs.	Agriculture	Housing	Automobiles	Household goods
1919	13,867	5,685	7,270	912 ^{1/}	347	268	132	123	155	2,831	500	1,329	1,800	1,660	3,810
1920	15,944	7,172	7,560	1,212 ^{1/}	617	447	204	162	181	3,540	657	1,364	1,122	2,038	4,400
1921	12,833	4,385	6,898	1,550	536	288	230	100	137	1,945	600	549	1,841	1,367	3,690
1922	15,337	4,919	8,764	1,654	433	408	266	151	236	2,097	645	683	3,115	1,819	3,830
1923	19,809	7,013	11,201	1,595	1,072	738	320	180	245	2,818	735	905	3,980	2,641	4,580
1924	19,972	6,736	11,374	1,862	879	844	386	133	355	2,535	761	843	4,244	2,470	4,660
1925	21,753	7,151	12,496	2,106	742	787	387	123	300	2,815	990	1,007	4,754	2,702	5,040
1926	22,788	7,846	12,790	2,152	876	718	407	116	380	3,220	1,177	952	4,314	3,116	5,360
1927	22,002	7,516	12,126	2,360	760	738	399	130	427	2,918	1,206	938	4,064	2,652	5,410
1928	22,645	7,821	12,363	2,461	663	701	460	135	348	3,254	1,181	1,079	3,813	2,890	5,660
1929	23,315	9,127	11,786	2,402	840	793	620	135	369	3,990	1,186	1,194	2,623	3,253	5,910
1930	18,714	7,473	8,464	2,777	859	855	616	124	298	2,827	997	897	1,456	2,038	4,970
1931	13,369	4,473	6,327	2,569	365	555	410	132	243	1,665	582	521	1,005	1,402	3,920
1932	7,712	2,258	3,622	1,832	175	265	255	61	141	826	274	261	282	780	2,560
1933	6,828	1,868	3,637	1,323 ^{2/}	108	120	167	46	72	866	143	346	204	963	2,470
1934	9,228	2,792	4,619	1,817 ^{2/}	224	137	180	78	77	1,436	165	495	214	1,325	3,080
1935	11,362	3,464	6,159	1,739 ^{2/}	197	179	195	117	92	1,712	209	763	585	1,954	3,620
1936	15,464	4,592	8,296	2,576 ^{2/}	314	256	250	109	120	2,342	272	929 ✓	1,200	2,496	4,600
1937	17,732	6,311	8,950	2,471 ^{2/}	525	425	390	101	150	3,200	360	1,160 ✓	1,280	2,570	5,100

^{1/} Excludes special war-time military construction.

^{2/} Work-relief expenditures deflated to a "regular equivalent" basis.

Estimates compiled by George Terborgh