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Carroll

NOTES ON FISCAL POLICY

I. Educational Task of Economists

One of the difficulties in pursuing a fiscal policy designed to meet the needs of the situation I have been describing is to be found in the lag of the development of ideas behind the change in economic conditions. Most people have been brought up on a set of economic doctrines and concepts which are appropriate to a period of rapid economic expansion and unlimited investment demand. The idea that saving should be encouraged and consumption restricted in every possible way, that the Government should adhere strictly to a balanced budget, that private investment must necessarily lead the way toward higher levels of national income--all these ideas are products of a period of economic expansion and heavy investment demand. It is understandable that people have difficulty in adjusting themselves to a change in conditions which calls for a new set of concepts and a new orientation of policy.

The task of economists in educating the public to the requirements of present-day economic conditions is both vast and urgent. The question inevitably arises: Have they done and are they doing all that they might toward the fulfillment of this task? Several specific

illustrations might be given of the confusion which has resulted from the intellectual lag I have just mentioned, and of the service economists could render in clarifying the issues involved.

Perhaps most common of all complaints at the present time is that business men lack confidence and hence are unwilling to undertake investment expenditures. Many economists say that, although they personally agree as to the necessity and wisdom of much that the Administration has done, they feel it has none the less retarded economic recovery because of its adverse effect on business confidence. This is particularly true with respect to Government deficit spending, which can only be beneficial so far as the actual conduct of business is concerned. Deficit spending increases consumer incomes and hence is bound to increase the effective demand for the things business men have to sell. It is surely an irrational sort of fear that would make business men limit their capital expenditures because the demand for their products is being sustained and increased. To the extent that such fears do exist--their importance is unquestionably much exaggerated--economists have an extremely important educational job to do. It is up to them to show that in reality business men are mistaking the cure for the cause. Fundamentally, the current lack of confidence arises from the same set of circumstances that make public investment necessary.

Another example of public confusion is furnished by the reactions to the term Government spending. According to the attached account of the Gallup poll on spending, 61 percent of the people interviewed said that they thought the Federal Government is spending too much. This public reaction appears, however, to be the product of a vague feeling that "spending" is bad rather than a desire to see specific types of expenditure cut. A later poll asked specifically about various major categories of expenditure. The question put to those interviewed was: "Do you think Federal spending should be reduced by 10 percent on?"--there followed the list of items. Over 80 percent of people answering the question said they did not favor any reduction in either defense outlays or in the money spent for old-age pensions. Sixty-two percent were opposed to any reduction in farm benefits. Slightly over half, 53 and 57 percent, respectively, did favor a reduction in public works and in relief. The only large majority for reduction was on the item "Ordinary Operating Expenses"--again, a general rather than a specific category.

Relief is the outstanding specific item where a majority--though not a large one--favor reduction. The reasons for this attitude have been clarified by a more recent poll in which the Gallup Institute asked the question: "Do you think there are any persons on relief in your community who could get jobs in private industry if they tried?" Sixty-nine percent of those interviewed answered, "Yes". Asked about

what proportion of persons on relief they thought could obtain jobs if they tried, these people named an average figure of 25 percent. Such a response is clearly based on a general impression gathered from newspaper stories and the like rather than on specific information about employment opportunities. People who are familiar with actual conditions report with striking unanimity that jobs simply are not available. Actually the number on relief is less than half the number out of work. Some 800,000 people have actually been certified as in need and capable of doing work on WPA, whom the WPA is unable to employ. Many of these people are meanwhile cut off from local assistance.

II. Flexibility and Forecasting

The difficulties of accurate business forecasting are well known. Constant efforts should be devoted to improving sources of information and techniques of prediction, but even with considerable progress along these lines, a large element of uncertainty is bound to persist. The Budget prepared in November and December 1938 had to cover expenditures and receipts in the first half of 1940. This means that successful fiscal policy must contain a considerable amount of flexibility. At the present time there are many obstacles in the way of proper flexibility. Congress has lately moved in the direction of depriving the Executive of discretionary power in the control over expenditures. Likewise little progress has been made toward the

important objective of long-range appropriations for public works and work relief. Commendable attempts have been made, especially by the National Resources Committee, to plan ahead in laying out and analyzing projects, but efforts have been handicapped by the scattered cooperation of State and local authorities.

Recently the local governments have even been moving in the opposite direction and abolishing, for reasons of "economy", some of the planning boards that had already been set up. Violent fluctuations in the activity of industries, such as automobile, steel, and textile make it essential that the Government have machinery for rapidly absorbing people thrown out of work by wholesale layoffs. This is one of the important reasons why the WPA type of program should be continued since employment on long-range, heavy public works cannot be varied quickly enough to counteract such shifts in private employment.

III. Administrative and Legislative Efficiency

Our governmental machinery is not well adapted to the needs of the present time. In the Executive branch of the Government it does look as though progress were being made. The passage of the Reorganization Bill and the President's recent Executive Order are milestones on the road to a more efficient and better coordinated administrative set-up. In the broader sphere, however, the outworn system of checks and balances still holds sway. Friction between the Executive and the Legislature has in fact been increasing in the last year or so. We are

beginning to see again the disadvantages of divided responsibility which has hampered the operation of our Government in critical periods of the past. (1918 to 1920, 1930-32 are striking examples.)

People frequently make the mistake of thinking that criticism of our cumbersome governmental machinery is a criticism of democracy itself. There could be no greater mistake than the identification of democracy with a particular organization of the governmental instruments through which it functions. Other democracies, England and Sweden are notable examples, have long since abandoned the elaborate system of checks and balances which we still insist on preserving. Far from being weakened, democracy has been strengthened in these countries by the more efficient functioning of their governmental machinery.

The Executive must necessarily prepare and initiate legislation. And yet, under our setup members of the Administration are unable to explain and defend their proposals on the floor of Congress itself. The position of the top administrative offices is a doubly difficult one: On the one side they are forced by circumstances to concern themselves with legislation although they have no recognized status in this field. On the other, they are loaded down with the burdens of purely administrative jobs of running the vast departments and agencies which they head. So much of the time and energy of these officials is taken up with administrative and personnel detail that they are unable to perform adequately their other function of policy formulation with its inevitable accompaniment of political strategy and political responsibility.

SOME POTENTIALITIES IN THE FIELD OF PUBLIC INVESTMENT

1. Public Housing

It is estimated that there are seven and a half million families in this country who are at present ill-housed and are in the lowest income third of the population, for whom new houses will not be built by private enterprise. If we assume that 60 percent of this number, or four and a half million families, could be housed over a fifteen-year period, this would amount to 300,000 housing units a year. At an average price of $3,500 per unit this would amount to about $1 billion a year of public investment of non-competitive nature.

2. Hospitals

According to the Technical Committee on Medical Care, there is a need for about 400,000 additional hospital beds today, which would cost $1.1 billion.

3. Drainage Basin Programs

According to the Report on Drainage Basin Problems and Programs, based on the findings of forty-five joint State and Federal basin committees, there is a need for 3,484 pollution abatement and sewerage projects, costing $667 million, and 2,678 water supply projects, costing $567 million. These are in addition to necessary Federal projects for the conservation of water resources of $891 million.

4. Other Non-Federal Public Works

As of January 18, 1939, there are a list of applications of the Public Works Administration for projects aggregating $1,775 million for which no money was available.

5. Miscellaneous Self-Liquidating Public Works

(a) Plans have been developed by the Bureau of Public Roads for revenue-yielding types of public investment, such as toll roads, tunnels, bridges, municipal express highways and boulevards through congested areas, etc., aggregating nearly $3½ billion.

(b) Rural rehabilitation loans, farm tenancy loans, U. S. Maritime Commission loans, rural electrification, etc.

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SOME POSSIBILITIES FOR THE EXPANSION OF PRIVATE INVESTMENT

1. Mining and Manufacturing

It is not generally appreciated how small relatively is the outlet for savings afforded by necessary capital expenditures in mining and manufacturing. Annual expenditures of $3 billion in the years 1923-28 in this field for new plant and equipment were not only adequate to replace equipment, but also to add greatly to the productive capacity in these years. In 1937 capital expenditures in mining and manufacturing amounted to slightly over $3 billion. The Index of Production would have to be between 120 and 130 for some time before we could reasonably expect to get $4 billion of expenditures in this field. It is true that a lot of the equipment is out of date, but this is always true, as various surveys in the Twenties indicated.

2. Utilities

The 1929 volume of capital expenditures in the utilities (including electric power, telephone, transit and others) amounted to nearly $2 billion. In 1937 it amounted to slightly over $1 billion. The main determinant of investment in this field, particularly in electric power, appears to be output in relation to generating capacity. Detailed analyses of prospects for capital expenditures in each of the main utility fields that have been made in the Division offer little hope that the yearly volume of expenditures will exceed the 1929 figure even if full employment is attained in the next few years.

3. Railroads

Throughout most of the twenties, the yearly volume of capital expenditures by railroads amounted to between $700 million and $900 million. The retirement of equipment in excess of additions in the past eight years has created a real backlog of demand should railroad traffic increase. On the other hand, the absence of secular growth in freight traffic, the increasing efficiency of equipment and the poor financial condition of many roads, tend to hold down capital expenditures. It may be doubted, therefore, whether the yearly volume of expenditures, even under the influence of full employment, will exceed $800 million. The volume in 1937 was $500 million.

4. Residential Construction

It is apparent that the volume of capital expenditures that can reasonably be expected to occur in mining and manufacturing, utilities and railroads, even under the most optimistic conditions, will not begin to provide the necessary offsets to the savings of a high national income. Prospects in private residential building, therefore, are peculiarly important. It has been estimated that, in addition to the normal growth in families, there is a special demand for housing of around one million units arising from the after effects of the long depression. Assuming that this demand could be made up evenly in a five-year period, and that the normal yearly growth of 500,000 families is met, a housing market for some 750,000 units is

available. This would amount to between $3.5 and $4 billion yearly. The attainment of this yearly volume, however, depends upon the failure of costs to advance significantly, upon the growth in consumer income, and upon the present backlog being made up. Given these favorable factors, a larger volume of construction than just mentioned would depend upon demolitions of existing structures. Evidently, this is the most promising field for capital expenditures.

5. Other Capital Expenditures

It is problematical whether the special factors that gave rise to a yearly expenditure of nearly $2 billion in the late twenties on commercial buildings and construction by non-profit institutions (churches, colleges, etc.) will be duplicated in the near future. Capital expenditures in agriculture, which amounted to $1 billion in 1937 as contrasted with $960 million in 1929, may be expected to increase little further.

Conclusion

When a canvass is made of the possible outlets for savings in the various fields of private capital expenditures, it becomes evident that the total that could reasonably be expected on the basis of full employment, does not add up to enough to match the savings even of an $80 billion national income.

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APPROXIMATE PERCENTAGE OF CAPACITY
VARIOUS INDUSTRIES ARE OPERATING

Steel	50%	
Cotton	85%	(on basis of 80 hours, 2-shift week)
Automobile	65 - 70%	
Cement	35%	

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SOCIAL SECURITY COLLECTIONS AND BENEFIT PAYMENTS

(Accrual basis)

	1937	1938	1939
Title VIII (old age) collections	579	*513	*555
Old age benefits	1	10	*25
Unemployment collections (State and Federal)	687	*930	*975
Unemployment benefits plus Administrative grants	22	437	*495
Net withdrawal	1,243	*996	*1,010

*Estimated

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SOURCES OF FUNDS FOR CAPITAL EXPENDITURES ON PLANT AND EQUIPMENT, 1929-1937

Producers' Capital Outlays

		Financed From		
	Total	Stock Issues	Long-term Borrowing	Other Sources
1929	10,250	1,200	1,550	7,500
1937	7,300	150	700	6,450

It will be observed that even in 1929, the peak year of producers' capital outlays, "other sources", comprising mainly depreciation accounts and retained earnings, furnished the overwhelming bulk of funds for expansion. The capital needs of all industry offered only a net outlet for $1½ billion of long-term fixed interest-bearing investment.

HOUSING CONSTRUCTION AND MOTOR VEHICLE PRODUCTION IN GREAT BRITAIN, 1930-1937

Year Ending in Sept.	Housing Construction		Motor Vehicle Production		Total Motor Vehicles in Use (000)
	Number in 000's	Index	Number in 000's	Index	
1930	162	100	237	100	1,560
1931	195	120	226	95	1,588
1932	202	125	233	98	1,643
1933	218	134	286	121	1,739
1934	314	194	342	144	1,874
1935	319	197	404	170	2,071
1936	340	210	461	194	2,272
1937	337	208	508	214	2,462

Source: Britain in Recovery, British Association Research Committee. The index was computed from the production figures.

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SHIFT SINCE 1929 TOWARD TAXES WITH REPRESSIVE EFFECTS ON CONSUMPTION

(Amounts in millions of dollars)

	1929		1938	
	Amount	Percent to total	Amount	Percent to total
Summary				
Taxes bearing primarily on consumption	1,055	29.8	3,415	50.3
Other taxes	2,485	70.2	3,370	49.7
Total taxes and customs	3,540	100.0	6,785	100.0
Detail				
Taxes primarily on consumption:				
Payroll taxes:				
Direct Federal collections	-	-	755	11.1
Deposits by States	-	-	748	11.0
Total	-	-	1,503	22.1
Tobacco and liquor taxes	447	12.6	1,136	16.7
Manufacturers' excise taxes	6	0.2	417	6.2
Customs	602	17.0	359	5.3
Other taxes:				
Corporate income tax *	1,236	34.9	1,337	19.7
Personal income tax	1,096	31.0	1,286	19.0
Estate and gift taxes	62	1.7	417	6.2
All other	91	2.6	330	4.8

* Includes excess-profits tax

The trend of State and local taxation has been in the same direction. The States raised about $600,000,000 from general sales taxes, liquor and tobacco taxes in 1936, sources of revenue which were of negligible importance in 1929. In addition State gasoline tax collections amounted to $256 million more than in 1929. Collections from those various sources have, if anything, increased since 1936.

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INVESTMENT OUTLETS:
1928 and 1937

(Millions of dollars)

	Total Producers' Durable	Mining and Mfg.	Utilities	Railroads	Commercial Buildings	Residential Housing	Inventory Change	Foreign	Net Contribution all Gov. units	Change in Consumer Debt
1928	8,751	3,254	1,644	673	1,181	4,000	+ 100	+725	605	800
1937	7,318	3,200	1,036	525	367	1,450	+4,000	- 24	801	1,000

CASH POSITION OF 133 INDUSTRIAL CORPORATIONS 1/
Dec. 31, 1935 to Dec. 31, 1938

	Cash	Marketable securities	Total
December 31, 1935	$327,336,000	$153,145,000	$480,481,000
June 30, 1936	336,216,000	163,307,000	499,523,000
December 31, 1936	356,960,000	128,891,000	485,851,000
June 30, 1937	309,459,000	135,323,000	444,782,000
December 31, 1937	325,134,000	147,377,000	472,511,000
June 30, 1938	374,159,000	121,654,000	495,813,000
December 31, 1938	2/ 482,973,000	111,353,000	594,326,000

1/ Sample of large and medium-size industrial corporations which publish semiannual balance sheets -- automobile companies excluded because of large seasonal fluctuations.

2/ Increase in part accounted for by security issues.

CASH HELD BY 49 LIFE INSURANCE COMPANIES
(with 92% of the Admitted Assets of
All U. S. Legal Reserve Companies)

December 31, 1929	$117,657,000	
December 31, 1930	126,158,000	
December 31, 1931	149,316,000	
December 31, 1932	291,038,000	
December 31, 1933	416,337,000	
December 31, 1934	557,608,000	
December 31, 1935	761,737,000	
December 31, 1936	785,608,000	
December 31, 1937	667,316,000	
December 31, 1938	750,000,000 (est.)	1/

1/ Estimate by Association of Life Insurance Presidents.

Corporate Profits

and the National Income

Net corporate profits, excluding intercorporate dividends, amounted to $1.7 billion in 1935, $3.9 billion in 1936, and were probably running at the rate of $5 billions in the first three quarters of 1937. Corporate profits in manufacturing alone in 1936 were actually as high as in 1927 -- $2.6 billions -- although the national income was $10 billions less and the extent to which plant capacity was being utilized was, of course, considerably less. This suggests that profits for non-financial corporations, on the basis of an $80 billion national income, will considerably exceed the profits of 1929, and hence that the savings of the community on this score would be larger than in 1929.