

CAN CAPITALISM BE SAVED

When I received an invitation to speak in Boston I accepted with ~~pleasure~~ <sup>pleasure</sup>. I have always had the feeling, probably quite unreasonably, that good Bostonians always looked a trifle askance at anyone who came from ~~any place~~ west of the Alleghanies, particularly Utah. The fact that in a recent magazine article my appointment to the Federal Reserve Board was interpreted to mean that the "Great American Debtor" had come into his own could hardly have been reassuring to you. I ~~had~~ <sup>have</sup> hoped therefore that by a personal appearance I might convince you that I am not a wild man but rather a conservative, that is, one who wishes to conserve our present economy and our present form of government.

~~In my speech~~ <sup>last before the Ohio bankers</sup> at Columbus ~~on~~ Tuesday I made the statement: ~~that~~ "if there is one thing seems clear it is that unless conscious effort is made to prevent them, booms and collapses will continue to occur in capitalistic democracies. It also seems evident to me that neither capitalism nor democracy can survive another depression of the magnitude of the one from which we are just emerging, <sup>or at least I hope we are emerging</sup>. Therefore it is absolutely essential to develop agencies which by conscious and deliberate compensatory action will obviate the necessity of drastic downward or upward adjustments of costs and prices, wages, and

out at up  
 Requir

capital structures". This is a theme I should like to elaborate more fully tonight.

Let me first clear the ground by emphasizing that our objectives are the same. I am speaking to you as a capitalist to capitalists, as a banker to bankers. As a capitalist I wish to preserve (and conserve) private initiative and private enterprise. Our objectives therefore do not differ. Our differences, and ~~I am sure they are~~ <sup>there may be</sup> many, are solely in the means of achieving our common objectives.

There is one further point I wish to dispose of before I proceed. I do not wish to preserve capitalism for its own sake. To me there is nothing sacred or inviolate about the system. It is merely an economic organization and structure which society has developed in its quest to satisfy its wants. If I wish to preserve capitalism it is because I think that a smoothly functioning democratic capitalistic system offers a better guarantee, ~~at least for this generation,~~ of what is generally termed the good life than does a capitalistic dictatorship, or socialism, or communism.

*out* If, then we regard capitalism <sup>(</sup>with its institutions of private property, private ownership of the means of production, and private enterprise, <sup>) simply</sup> as a particular economic organization of society, our defense of, or attack on, that organization must be directed toward its efficiency,--its ability to satisfy in an adequate and equitable fashion the material needs of mankind.

out (17)

If it cannot be defended on these grounds it is doomed. The doctrine of the divine right of kings did not save Charles the First's head nor will the doctrine of the sacred rights of property save capitalism. People want and will demand concrete and material results. Private enterprise today is on trial solely because it is not producing the goods it has the capacity to produce and because it is not providing a more equitable distribution of the goods it is producing. I hope that you will not think that I am exaggerating. (A society such as ours is highly unstable.) Over twenty million people, or one-sixth of the population, are being supported by the Federal Government. In addition, there are millions more being supported by their relatives or using up their savings. The important thing from the point of view of the preservation of capitalism is that these people no longer have any stake in preserving our present economy. They have nothing to lose. <sup>and</sup> If this condition persists much longer, or if it recurs again in a few years, neither you nor I will have anything to lose.

There are, therefore, two supremely important and related questions that must be asked and answered. How can recovery be achieved? How can recovery, once achieved, be translated into a period of enduring and sustained prosperity? My general answer to both questions is that recovery will be achieved and maintained only by conscious and deliberate effort on the part of the Government <sup>which represents society as a whole.</sup> ~~and the Reserve Administration.~~

Let me first examine the opposing argument. It states quite baldly that any efforts to ameliorate our condition or to strive for recovery through governmental action will either be totally ineffective or actually harmful. All we need to do is to complete the process of liquidation, get wages down, have no legislation that threatens profits or interferes with business in any way, and then have faith in America. We recovered from other depressions without governmental aid and we will recover from this one.

What does completing the process of liquidation really mean? It can only mean the closing of banks which have impaired capital, foreclosing mortgages on much of the real estate of the country, putting many of the railroads into bankruptcy, scaling down municipal debts, and so on. While this process is going on it is expected that incomes and the demand for goods will continue undiminished. If incomes decrease, however, as they will, further liquidation will be necessary and the process will continue until we are all out of debt, -- and starving. We went a long way toward this goal from 1929 to 1932.

*Diagram*

The next thing we are told to do is to get wages down. This is definite enough, but you could get wages down only by strong-arm tactics, and only after prolonged strikes with resultant depressing effects on business activity. Incomes or spending would certainly decline in the process, and wages would have to be lowered still further, and so on.

The people who tell us to have no more legislation that threatens profits or interferes with business are particularly blind to the spirit that is abroad in the land. They would accomplish this, I suppose, by denying the vote to the majority of the citizens, and by expecting the President to veto most bills sent up by Congress, and pray that his vetoes be sustained.

Let us now examine the basis of the view that business alone and unaided will stage its own comeback. So far as I can discover, this view is based on two arguments. The first is that since it has always come back in the past it will now. To my mind, however, this is not an ordinary depression, it is a catastrophe. Never before have we had so many of our industries operating at from twenty to sixty percent capacity; never before have we had such a complete international breakdown; never before have we had to contend with so many rigidities in our economic structure; never before have we had such a drastic percentage of decline in our national income; never before have we had one-sixth of our population destitute and on the relief rolls. It is said that as a people we like to break records. We have certainly done ourselves proud in this respect since 1929. What right, therefore, have we ~~te-~~

to assume that the same forces which pulled us out of depressions in the past will get us out of this cataclysm? Do the people who believe this know the nature of those forces? Have they been able to show that this depression differs in no wise from previous ones? Until they have answered these questions satisfactorily, I must differ with them.

(A. Digression)

*(Next sheet - re England)*

The second argument for natural recovery is that wear and tear and obsolescence will call for enormous replacements sooner or later. We do not hear this argument so often today. I was reminded of it by the recent statement of one of our former leaders that replacement requirements would result in a boom by this coming June. Experience has given answer to this argument. We can let our equipment run down indefinitely if we have not the money or the credit to maintain it or the business to justify it.

At "A" -(Page 6) [I would suggest a digression regarding <sup>out</sup> England to the effect that ~~the~~ many people have pointed to England as an example of successful progress toward recovery without the legislative measures adopted by the United States administration. English unemployment in January was greater than in any January during the past five years. About one-fourth of their population is supported by unemployment insurance and the dole. The English Government debt represents  $2\frac{1}{2}$  years of their national income against six months in this country. At the same time, the credit of England was never better as evidenced by the extreme low interest rate on government borrowings. This in spite of the fact that taxes in England are much higher than in this country.

Thus, from consideration of the English situation we prove two things -- 1. The English progress toward recovery is not inspiring and, 2. The statement that the government credit is in danger is ridiculous in view of the English credit situation under a government <sup>tax and debt</sup> load many times heavier than ours.

~~in the blackest years of the depression.~~

*Begin* →

Having unburdened myself on the laissez faire theory, I propose now to give my critics a chance by turning to the more constructive part of my address.

I must begin by giving you my diagnosis of <sup>all</sup> ~~the ills of the body~~ economic <sup>ills</sup> and the conditions for its sustained health.

As a first approximation let me put the problem very simply. We have the man power, the raw materials, the equipment and the technical knowledge to produce vastly more goods and services than we are producing. What, then, is holding us up? The ~~proximate~~ answer is likewise simple. It is lack of effective money demand. As a community we want all the goods we can produce, in fact we are in dire need of them. The difficulty is that the people who need the goods have not the money income out of which to buy them and many who have income are unwilling to spend it.

Omitting consideration of the Government for a moment, we have evidence that the bulk of the demand deposits today are held by *the larger* corporations and <sup>well-to-do</sup> ~~perhaps wealthy~~ individuals. The money holdings of the majority of the people amount to a low figure in the aggregate. The money holdings of corporations, if spent at all, will be spent on production, equipment and construction. Moreover, again omitting consideration of the Government, if new money is to be created it must be by loans which are mainly for the purpose of production and construction, and not consumption. We finally arrive, therefore,



at the familiar point that in order to have a full and sustained recovery there must be large and continuous expenditures by businesses on inventories, equipment and plant *or in the field of home construction*

Why are business men not making larger commitments for plant and equipment? Why are individuals and corporations not building more houses, apartments, hotels and office buildings? Why are municipalities not spending more on public works? The business men and bankers had, at least until recently, the same answer in each case,—lack of confidence. But the question immediately presents itself, lack of confidence in what? Is it not really, in the case of business men and individuals, lack of confidence that increased investment will prove profitable? If, in other words, the costs of building and operation were less than the probable returns from a building, would speculative builders refuse to build? Would a manufacturer refuse to extend his plant or equipment if he saw a likelihood that orders on a profitable basis would overtax his present capacity? Would a municipality hesitate to extend its public buildings if the incomes and property values of its residents were rising?

We see, therefore, that lack of confidence means the absence of belief that new investment will prove profitable. The question then becomes, why not? The proximate answer is in almost every case the existence of unused productive capacity. While existing plant will be used if *little is nothing* (anything at all) can be earned on it, new capital will be invested only if it is expected to earn more than the going rate of interest on new borrowings. Only two industries in 1933 suffered

from a shortage of productive equipment—alcoholic beverages and gold mining. In both cases <sup>an abundance of</sup> capital was invested in new equipment.

The absence of residential construction, on which in the years 1923-1928 some three billion dollars was spent annually, requires a special explanation. The excess capacity in housing is low relatively to that in office buildings and factories and yet there has been virtually no pick up in this field. The answer is again simple. The decline in people's incomes has brought about a decline in rents. Building costs, however, are almost as high as they were in 1929. This is due to the maintenance of wages in the building trade, and the increase in the cost of building materials, and the <sup>the</sup> ~~high cost and~~ difficulty of obtaining mortgage money <sup>on a satisfactory basis.</sup> Consequently, in the great majority of cases, it is cheaper to rent or buy than to build. This condition will continue to prevail until either rents rise or costs fall.

To return to the question of confidence. It might be said that although in practically all industries it is not economical to provide new equipment to meet existing demands, still it would be profitable to build now if there were assurance that in, say, two years such new facilities could be used to capacity. It is said that this assurance will be lacking as long as (a) the price of gold in dollars is not permanently fixed and (b) the Federal budget is unbalanced. If uncertainty on these points were removed construction and equipment buying of all kinds would get under way.

This argument may be met in two ways; in the first place we may question ~~the reality of the economic motivation implied.~~ *whether stabilization would inspire confidence.*

Secondly, we may follow out the economic consequences of the adoption of these two measures.

Conservatives are opposed to both the present character of our gold standard and to the unbalanced budget for the same reason,—the possibility of "inflation" under such conditions. Inflation is used in many senses but it appears to connote generally among business men and bankers a condition of rapidly increasing demand for goods of all kinds culminating in a rapid rise of prices. A full gold standard and a balanced budget would lessen the possibility of such a rise of prices, and would make for greater certainty that the present level of prices and cost would persist. It is difficult to see why the less likelihood there is of rising prices, the more eager industrialists will be to extend plant. Yet this is what in effect the people who advocate the above proposals are maintaining. Certainly, an unquestioned gold standard and a budgetary surplus in 1929-30 did not prevent a decline in business, and a gold standard and serious efforts on the part of the Administration to balance the budget in 1931-32 did not prevent a further decline in business.

Let us now consider the direct possible economic effects of fixing the gold price permanently and balancing the budget.

Suppose that we fix the price of gold permanently and that then most of the other countries devalue at such points as to afford them favorable balances of payments with the United States. We would lose gold. It is true that at present we possess such large stocks of gold that we could lose an enormous amount before we would have to restrict bank reserves. It cannot, however, be doubted that the financial and business community would interpret a heavy loss of gold bearishly. Moreover, it cannot be doubted that a rapid and considerable fall in foreign exchanges, or rise in the value of the dollar in terms of foreign currencies, would affect adversely the prices of some of our big export crops temporarily. This, in turn, would mean inventory losses, curtailment of incomes for large sectors of the community and a generally depressing psychological effect. By refusing to commit ourselves on the price of gold before other countries have done so we lessen the possibility of such eventualities occurring. It is significant in this respect that England has not even committed herself to the extent that we have.

Balancing the budget requires either a curtailment of expenditures or an increase in taxes, or both. Governmental expenditures are also individual incomes. A contraction of expenditures, therefore, means other things remaining unchanged, a contraction of incomes with a probable contraction of the demand for goods, which in turn involves further contraction of incomes. With each decline in incomes

the ability to pay taxes and the yield of taxes and money rates decline. An increase in taxes, in so far as taxes are paid out of current income which would otherwise be spent, has a tendency to decrease current expenditures other than public. This results in increased unemployment, business losses and decreased ability to pay taxes. \* People who advocate a balanced budget as a recovery

measure are gambling that a certain reduction in ~~monetary~~ incomes will be more than offset by the increase in incomes which will result from the increased ~~spending of business men and individuals~~, which is expected to follow an increased certainty that prices will

not rise. ~~Let me repeat this. People who advocate a balanced budget as a recovery measure are gambling that a certain reduction in monetary incomes will be more than offset by the increase in incomes which will result from the increased spending of business men and individuals, which is expected to follow an increased certainty that prices will not rise.~~ \* The Administration can hardly be blamed for refusing to take part in such a gamble.

*resulting from reduced public spending*  
*private spending*  
*out*

In my opinion the real deterrents to building are to be found in the existence of unutilized capacity and the gap between costs and rents in the residential housing field. *These problems can be solved alike by* (The only effective way to decrease unutilized productive capacity is to bring about a large increase in the demand for goods of all kinds. Should consumers' income and expenditures increase considerably, more and more industries will be able to approach capacity production and ~~making~~ additions to plant would again become profitable. Similarly,

if incomes increased the demand for housing accommodation would increase, rents would rise and it would again become profitable to build.

Federal expenditures in the form of relief cannot increase income sufficiently above the present level to lead to an increased demand for goods sufficient to result in new building. The average payment per family is around \$25 per month. Relief expenditures merely tend to prevent the demand for goods from falling below present levels. We might drift along for years at the present level while supporting twenty million people at a bare minimum of subsistence.

Increased expenditures on durable goods not only increase the demand for the products of industries in which the bulk of unemployment occurs, but also actually increase incomes. Hence, from the standpoint of recovery, Federal expenditures which result in an increase in construction are far superior to expenditures for relief.

My diagnosis of the present situation runs, therefore, in terms of a lack of effective monetary demand resulting in unutilized productive capacity and low rents, which in turn act as deterrents to business expenditures and residential construction. My prescription is government spending on a scale sufficient to increase incomes and the demands for goods to absorb much of our unused capacity and to make it profitable for business to expand. Also by increasing incomes I would hope to bring about a rise in rents and thus make it again profitable to build.

You may object that we have tried this method and that it has failed. But have we really given this method a fair trial? If you have had any experience with priming a pump you will know that a little trickle of water will not do the trick. You must prime vigorously if you want the pump to start pumping on its own account. Our federal pump priming operations may have appeared large absolutely, but actually they have been little more than a trickle in relation to the size of the pump. Deducting refinancing operations, our federal pump priming deficit, that is, the amount over and above our revenue which we spent to increase incomes, amounted to only about three per cent of the national income of 1932, four per cent in 1933, and probably very little more of the national income of 1934.

I think that the opposition to the pump priming theory can be largely attributed not to the fear that it would be ineffective but that it would be too effective, that in other words it would lead to inflation. (Since) Inflation means a state of affairs in which for a considerable period incomes are increasing much more rapidly than goods can be produced so that prices are rising sharply. ~~(and since)~~ <sup>But</sup> at the present time there is <sup>an</sup> enormous slack in our productive system so that increased incomes could be met for a considerable time by an increased output of goods, <sup>there</sup> inflation is to be feared only after we have achieved recovery.

Do pump priming operations by the government really expose us to the danger of inflation? I think not. In the first place,

priming operations will continue only so long as the pump needs priming. They will come to an end considerably before our system is working at full capacity. (In this respect they differ fundamentally from the deficit incurred in war financing, when the deficit increased steadily long after we had reached the limits of our productive capacity.) In the second place, the Reserve Administration can again assume its role of a compensatory mechanism if total expenditures of the community increase too rapidly. There can be no question of ~~our~~<sup>its</sup> ability to arrest the growth in the community's supply of money. ~~We have~~<sup>It has</sup> two and a half billion dollars of securities which ~~we~~<sup>it</sup> can sell and in this way take excess reserves away from member banks. ~~We have~~<sup>It has</sup> the authority to raise reserve requirements to any height the situation requires. In addition, the Treasury can transfer balances from member banks to the reserve banks, and in this way deplete member banks' reserves. There are still other ways in which expansion can be controlled.

There can be, I think, no question of ~~our~~<sup>its</sup> ability to prevent recovery from becoming inflation, and I assure you that there is no question of the Administration's desire to promote stability once recovery has been fully secured. ~~We are~~<sup>It is</sup> not, in other words, like a driver of a motor car who keeps his foot on the accelerator all the time. When the grade is steep we do not hesitate to use the accelerator. When, however, the car has gained sufficient momentum we shall not hesitate to apply the brakes. For my own part I should much prefer a driver who varies his action according to circumstances than one who continuously uses the accelerator or one who continuously uses the brakes.



I find that I have devoted so much time to my answer of the question, "How can recovery be achieved?" that my answer to the question, "How can recovery, once achieved, be translated into a period of sustained prosperity?" must be brief. Fortunately, I need spend no time in examining the views of my laissez-faire friends on this question, since their position is purely negative-- it cannot be done. So long as we have free private enterprise we will have ~~a business cycle~~ *booms & collapses*. They may very well be right but I will not concede the validity of their views until we have had a favorable opportunity to work for business stability, and have failed.

I believe, however, that there are means by which we may hope to achieve stability. Since it is the unguided profit motive which intensifies upswings and downswings we must therefore look to agencies which are not activated by profit considerations and hence may serve as counteracting or compensatory forces. Two such agencies are the Government and the Reserve Administration.

For the maintenance of stability, which to my mind is a necessary condition for the maintenance of capitalism, I should like to present for your consideration a three-point program.

First I suggest use by the government of its taxing power to lessen the inequalities of income, since I believe that maldistribution of incomes increases our susceptibility to booms and collapses. Secondly, I think that the Reserve Administration, if given adequate powers, may, through its control over the money supply, influence the rate of expenditures and thus act as a compensatory agent. Thirdly, I would look to the Government to counteract big increases or decreases of expenditures on the part of the community by varying its own expenditures.

I went into my philosophy of monetary control at some length in my address at Columbus, and I shall not devote more time to it here. In the course of my talk tonight I have already discussed variations in government expenditures as a compensatory device. I shall therefore confine my remaining remarks to the desirability of using the taxing power to lessen the maldistribution of incomes and in this way to promote economic stability.

I shall begin with the statement that if money is not being spent it is being hoarded. Let us see why this is. Spending may take place broadly on two main classes

of goods, -- consumers' and producers'. If money is saved, it is expected to be spent on producers' goods. If it is not so spent, it is hoarded. It is not difficult to show that the decreased spending during the depression has been primarily on producers' goods. Money saved, in other words, instead of exerting a demand for producers' goods, had gone in part into idle balances. I think it is fairly obvious that the holding of idle balances by the poor is not quantitatively important. The decreased spending by the poor can be attributed to their decreased incomes. The serious hoarding is by the wealthy and by large business corporations. The balances of these groups are normally spent on durable capital goods and at the present time, for various reasons, there is a disinclination to invest in such goods.

It thus becomes evident that the emergence of a wealthy class and the rise of large corporations have increased <sup>our susceptibility to booms and collapses, in a society</sup> in which incomes were more evenly distributed and in which corporations were not so large nor so wealthy a larger proportion of our current income

would be spent for consumers' goods and a smaller proportion on durable capital goods, and it has been demonstrated again and again that the money demand for consumer goods is far more stable than for capital goods.

The inequality in incomes in this country is not generally appreciated. In a recent study by the Brookings' institution, entitled "America's Capacity to Consume", it is stated that in 1929 one-tenth of one per cent of the families at the top received as much as 42 per cent of the families at the bottom of the scale. It is obvious that only a small portion of the incomes of the one-tenth of one per cent is spent on consumer goods. It is for the most part saved. If this saved money is not spent on producers' goods it is not spent at all. The consequence is an increase in unemployment and reduction in incomes.

There is still another reason why I think it is desirable to secure a better distribution of income. You will remember that I stated that capitalism will be judged not only by its ability to satisfy the material needs of mankind, but also by its ability to satisfy them in an equitable fashion. Can we possibly say that a system that in a prosperous year allocates to one-tenth of one per cent of the people as much income as it allocates to 42 per cent of the people is an equitable system? I do not think so, and I cannot see how the 42 per cent will long continue to think so.

In conclusion let me summarize my views very briefly.

I see nothing in our economic organization to lead me to believe that business stability will ever come about by itself. I think that without a fair measure of stability the system will not survive. <sup>and I believe</sup> I hope that the inherent instability of capitalism may be corrected by conscious and deliberate use of three compensatory instruments, taxation, varying governmental expenditures, and monetary control. You as capitalists have everything to gain and nothing to lose from the successful developments of such controls. It is to your own enlightened self-interest, and I have never spoken with more earnest conviction, to work for the establishment and success of compensatory controls. If they are not established or if they are not successful in achieving economic stability then, as surely as I am standing here, you will not have compensatory but direct controls in every important sphere of economic activity.

I am not proposing anything novel or completely untried. As you know, we have had a degree of monetary control since the war. We never permitted expansion up to the limits of our gold holdings. We have had a degree of progressive taxation and inheritance taxes. We had a big surplus up to 1930 and a deficit since. What is new in what I am proposing is that these factors be coordinated and consciously directed toward the end of promoting business stability.

It is, of course, possible that both my diagnosis and my prescriptions are mistakes. No economic analysis is capable of conclusive demonstration. All I can say in defense of my views is that they represent *a lot of serious thinking, close observation, and much discussion* ~~the hardest kind of hard thinking.~~ I believe I have the right to ask my critics that they also give real thought to our problems and consideration to the alternative/confronting us. It should be evident by now that simple maxims and rules of thumb are not sufficient. Our society is a living, growing, changing and complicated organism. One thing only we can be certain of and that is the continuance of change. All of us who have common objectives may hope by intelligent understanding and action to influence change in the direction we desire. If we fail to recognize our unity of purpose and adopt unintelligent and ~~purely~~ obstructionist tactics, we will inevitably hasten the very changes we seek to avoid.