

April 21, 1938.

Chairman Eccles

What is Wrong with America,

Lauchlin Currie

by Paul Gourrich.

Attached is a brief digest of Mr. Gourrich's memorandum on What is Wrong with America, which you requested from me sometime ago. I do not think that it is worth your while to read the long memorandum.

LBC: em

WHAT IS THE MATTER WITH AMERICA AND WHAT IS TO BE DONE?

by

Paul Gourrich

This seventy-three page memorandum covers a wide field and for the most part is couched in very general terms, so that it is difficult to summarize.

The first part of the paper is taken up with a very eloquent defense of capitalist democracy and the importance, for all kinds of reasons, of making it work. When we come to the section dealing with how it can be made to work we find a mixture of very broad generalizations and specific suggestions. Mr. Gourrich envisages a thorough-going organization of industry on the following terms:

"The building of a balanced economic structure must be similar to the construction of a house: from the bottom up. Each unit, each industry, must enlist all its experts and their talents to make a census of all its facilities, as well as to outline projects and opportunities, and on the basis of such information draw up a program which will insure a maximum of balance and gradual growth, clearly setting forth the conditions necessary to achieve that end so that the body whose task it will be to coordinate all industry -- the National Committee-- may have an opportunity to examine each program and compare it with those of other industries with a view to formulating broad national policies of a coordinating character." pp. 29, 30.

"The over-all economic round-table committee (a national planning board), by which the policies of each industry as well as those of other branches of economic life will be carefully studied, will have as its task the knitting together of specific programs into coordinated national policies. On this National Round-Table Committee representation should be given not only to capital, labor, management, consumers, and the government, but also to agricultural interests, banking interests, and other important national activities." p. 35.

I cannot help feeling that in the present conditions this is a little ambitious and unrealistic. The role of government is not clearly brought out here either. The following are the more specific suggestions:

1. "Some form of direct representation with adequate compensation for shareholders and others who act as directors must be an integral part of any program to render responsible, competent, and just the relationship between management and the rank and file of stockholders, because otherwise there is danger that those security holders may bring pressure to bear upon the government to do for them in their corporations what under existing conditions they have so far been largely unable to do for themselves." pp. 27, 28.

I am very skeptical of the possibilities of inducing shareholders to take an active part in the affairs of their corporations.

2. "To reopen the capital market, it may be necessary for the government to extend loans to or make investments in needy and deserving companies through an organization set up especially for such activities under the name of, say, Federal Industrial Bank. A system of Regional Industrial Banks may then be set up whose capital shall be furnished by the Federal Industrial Bank." p. 48.

"Because it is difficult to see how the private capital market under present conditions can be reopened on any substantial scale, few problems among the many which are troubling us are so pressing as the need for an immediate solution of the existing impasse in the capital market. Recommendations which should help considerably to revive the capital market in two important industries follow;" pp. 50, 51.

- "1. For public utilities, we aim at establishing economically sound rates and at eliminating duplication..." p. 51.
2. For railroads, consolidate or unify their operations in order to eliminate wastes; establish economically sound and flexible rates...." p. 51.

I have a feeling that too much stress is laid on the reopening of the capital market, at least for the larger firms. Such

firms never avail themselves to any great extent of the capital market. When they have the volume and the profits they have never experienced much difficulty in borrowing or in issuing stock. With the virtual repeal of the undistributed profits tax and the consequent incentive to retain earnings, larger industries will have an abundance of funds for expansion. When it comes to the financing of smaller industries I prefer your proposal.

3. Suggestions in the field of banking.

- "a. Further desterilization of gold, and possibly eventual lowering of reserve requirements as the need may arise.
- "b. Make it easier for banks to get back into the corporate bond market as investors through liberalization on the part of bank supervisory authorities of investment policies of banks.
- "c. Liberalization of bank lending policies.
- "d. Creation of bank investment instruments of from one to three years' duration in the form of extended certificates of deposit to cover banks' intermediate loans to industry of similar duration.
- "e. Cessation of silver purchases by the government through a system of gradual reduction of prices at which the Treasury will buy silver.
- "f. Coordination of the three Federal credit control agencies-- Federal Reserve Board, Federal Deposit Insurance Corporation, and Comptroller of the Currency - with regard to inspection of the banks' portfolios.
- "g. Also study the possibility of allowing commercial banks to act as underwriters, while at the same time being careful not to bring back the evils formerly experienced under the old system of security affiliates. To help avoid the use of the underwriting privilege for such purposes as bailing the banks out of bad loans, etc., it might be well to stipulate that no bank shall be permitted to assume underwriting commitments of any kind for corporations which are indebted to it and in no case to allow the banks to undertake more than 50 percent of the total underwriting in each

"instance. Regarding the stipulation that banks be not permitted to underwrite for corporations which are indebted to them, care will need to be exercised lest that prohibition be circumvented by mutual understandings between banks to let one do the underwriting for corporations which are indebted to the other. Under no circumstances should commercial banks be allowed to engage directly or indirectly in distribution and retailing of securities." pp. 52, 53.

#### 4. Taxation

"a. Study the possibilities of improving the tax system -- how to broaden its base; how to determine optimum points of surtaxes, capital gains taxes, etc.

"b. Modify the capital gains tax by, say, segregating capital gains into a special account which shall be settled on the basis of a three-year average, the government having the right to ask for adequate installments in anticipation of the three-year settlement, in order to prevent tax delinquencies.

"c. Modify the undistributed profits tax with a view to penalizing unjustified retention of earnings and exempt all other retentions, particularly those that lead to greater employment of labor." pp. 60, 61.

The implication throughout the treatment on taxation is that it bears too heavily on business and the wealthy, and that it will have the eventual effect of making capital scarce and expensive. I am not impressed with the treatment here. From my analysis of the 1937 situation I have concluded that despite higher taxes the volume of saving was just about as great as in 1925 and the national income was about the same as in 1937. This general implication of the shortage of capital occurs at other places throughout the treatment. For instance, in the following quotation:

"And, finally, the recession of 1937 has contributed another incontrovertible lesson: that neither the farmers nor the industrial workers, separately or jointly, (nor possibly even the government), can take too much of the national income at the expense of capital without disrupting the economy to the eventual detriment of all of them." pp. 10,11.

This implies that the share of capital in the national income diminished in 1937 and that there was an inadequacy of saving. Available statistical material gives no support to this view.

5. The wage problem. The suggestion is advanced that, if necessary, labor should be kept in line through the machinery of compulsory arbitration.

6. Budget problem. It is suggested that an attempt be made to balance current expenditures by current revenues and to carry capital expenditures in a separate account. There is also a suggestion, not worked out, that social security funds should be used judiciously for the purposes of economic expansion.