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POSTWAR
ECONOMIC PROBLEMS

Postwar Economic Problems

EDITED BY

SEYMOUR E. HARRIS

Author of "Twenty Years of Federal Reserve Policy"; "Exchange Depreciation"; "The Economics of Social Security"; The Economics of America at War"; and Others

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POSTWAR ECONOMIC PROBLEMS

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Preface

I wish to thank my wife, Ruth B. Harris, and Miss Dorothy Wescott, for editorial assistance. My wife has also kindly read the proofs.

As editor I wish to emphasize that all statements of the contributors are their personal views. They do not speak for any government agency or department with which they may be associated.

SEYMOUR E. HARRIS.

WASHINGTON, D.C.,
February, 1943.

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POSTWAR ECONOMIC PROBLEMS

INTRODUCTION

"Win the war first" is a sensible slogan. But all agree that if we do not also win the peace, we shall have lost the war. If we do not plan for and try to build the "right" kind of postwar world, the winning of the war will be of little avail and we shall not have won the peace. It is understandable, then, why almost every government agency is devoting some time to the study of the problems of the postwar world, and why numerous private research organizations are generously devoting their funds to searching analyses of the problems that will confront the United Nations in the years following the end of the war. Merely to catalogue and describe briefly the more important items subsumed under postwar economic studies has required a small volume, which has been compiled by the Twentieth Century Fund.[1]

Our main task today is, indeed, to win the war; toward that end we must devote our major resources and man power. But that is not tantamount to saying that unless we devote 100 per cent of our energies to the prosecution of the war—leaving the problems of the postwar world to brief future consideration and hurried treatment—we are being foolish and remiss. On the contrary, we would be remiss in our responsibilities—and stupid—if we failed to consider postwar problems *before* victorious peace comes. Our expenditures in terms of human lives, suffering, and toil, and the hundreds of billions of dollars of outlay, would be vain if, having achieved victory, we were not *ready* and *able* to take the necessary measures to mold our world of tomorrow in a manner consistent with the objectives of our current struggle.

There are some who object to a study of postwar problems on the grounds that the postwar world will be so different from what we can envision that any examination of the problem is likely to be futile. We do not share this view. To be sure, the economist

[1] Some of the views on postwar problems of men in responsible positions in Washington may be found in *Toward New Horizons: The World beyond the War* (Office of War Information, Washington, D. C.).

cannot estimate accurately the size of the postwar public debt, the price level, the level of output, the degree of control of economic activity by the government, and the value of many other variables at the end of the war. To that extent he is limited in the precision of his recommendations. He can be certain, however, that the economic problems will be numerous: employment; the division of authority and operations between government and private interests; the distribution of the shares of income; the contributions of governmental and private interests to total spending; the manner of carrying on international trade; social security; reconstruction both at home and abroad. The study of these problems *now,* will not be disadvantageous to the victorious peace yet to come.

Studies of the reconstruction periods following earlier wars suggest problems that will confront us in the next period of adjustment. Although these studies are valuable, allowance must be made for departures in the present emergency. Whereas our war expenditures attained roughly 30 per cent of national income in the First World War, they are likely to attain 70 per cent or more in the course of the present struggle. Military expenditures for the fiscal year 1943 are currently estimated at $80 billion; and expenditures at the rate of over $100 billion have been promised for the fiscal year 1943–44. In no previous war has the United States had to face a problem of demobilization on the scale envisaged for the period after the Second World War. Current estimates put the armed forces at a minimum of 11 million persons: our armed forces would be much larger if the proportion of the country's population inducted into the armed services were as high as the corresponding ratio for Germany. Workers in war industry will number at least 20 million persons, and they may well attain several millions more by the end of 1944.

Would it be better (as our critics say) first to be confronted with the numerous postwar problems and then to study them? The contributors to this volume answer "no." At the least, they suggest the important problems; at the most, they propose specific solutions.

At this point a brief analysis of spending, productivity, and income in the thirties is presented; and a word is said concerning their relevance for the postwar period.

In 1932 income was running at the rate of $40 billion annually. Few would have predicted that the national income, within a period of 5 years, would rise to $75 billion; and a forecast of an income of

$135 billion, the current estimate for 1943, would have been considered fantastic and visionary. Many have doubted that deficit spending played a significant part in raising national income by almost 100 per cent in the years 1932–1937. These skeptics pointed to the concomitant (and fortuitous) variation of public spending and the emergence of the recuperative powers of capitalism. They did not follow the President when, in a recent budget speech, he pointed to concomitant rises of (1) public debt of $30 billion, (2) annual debt charges of $400 million and (3) national income of $30 billion annually. (The annual rise of income had been 75 times the increase in the annual cost of servicing debt.)

Whatever the merits of the controversy concerning the years 1933–1940, there will be little doubt concerning the experience of 1940–1944. The following estimates give a rough idea of the changes wrought by war. National income will probably have risen by at least $60 billion annually; Federal spending by $90 to $100 billion annually; deficit spending by $60 to $70 billion; and stimulative deficit spending (*i.e.*, additional spending out of idle balances or through the creation of new money), $40 to $50 billion. There are few who would now deny an association of public spending with the rise of income or with the attainment of a position of full employment. Why if, under the impetus of spending for war, we can attain a position of full employment and (despite the large output for war purposes) the highest standard of living in the history of the world—as we have in 1941–1942—can we not achieve them in peacetime?

The depression years witnessed a remarkable advance in output per man-hour; but our gains were more than nullified by the large rise of unemployment and the reduction of employment. In more recent years, not only has unemployment declined to a minimum figure but the rise of employment (inclusive of the additions to the armed forces) has been several million more than the reduction of unemployment. In the 2 years ending June 30, 1942, the rise of employment and of numbers in the armed forces has been 9 million, two-thirds of which are accounted for by a reduction of employment. Estimates of the numbers in civilian employment and the armed forces are 48 millions in June, 1940, and 57 millions in June, 1942. If the numbers attain an expected total of 63 million or almost 50 per cent of the total population by the end of 1943, a very large influx into the army and industry from the home and farm will be required. By the end of 1943, expenditures for war material and war construction should be at an annual rate of $90 to $100 bil-

lion or more. Even with a rise of output per worker of 18 per cent from the end of 1941 to the end of 1943, 5 million new war workers will be required from the middle of 1942 to the end of 1943 in order to attain a rate of military expenditures of $85 to $90 billion.

Until quite recently man-hour output has continued to rise but not at the rapid rate of the years 1930–1935. Further increases in man-hour output and the maintenance of full employment will put a national income of $200 billion within our reach. Should our armed forces and workers rise to 65 millions and 5–10 million workers be added who ordinarily would not have been available—the size of our working population would be influenced in the postwar period. A substantial proportion would remain on the labor market. In the light of progress made in the last 50 years, a goal of $200 billion is not at all visionary. If the public continues to desert the home for the market place and industry, if productivity continues to rise even at a rate below that of the last generation, and if the large investments now going into war are in part shunted to private industry when they might be used to introduce new economies in the production process—saving both capital and labor—the day of an income of $200 billion at current prices is not far off.

A rise of national income to $200 billion in the next generation or two is easily attainable. The rate of industrial progress might even be less than it has been in the last 50 years. If the rate of increase in industrial production since 1919 were projected into the future (1940 = 100), the figure would be 485 in the year 2000; and the productivity (1940 = 100), no less than 800 in the year 2000. (We do not assume that a projection of the percentage gains for the years 1919–1920 to 1940 is an appropriate procedure.)

It will be necessary to stimulate consumer spending if a high income level is to be attained and maintained. Provision of security and an accompanying stimulation of spending; the further spread of education; an improved distribution of income; community spending for consumption—all these will be required. That an improved distribution of income is attainable is proved by the history of the years 1940–1942. Of a rise of national income of $45 billion, the largest part has accrued to labor and the farmers: their gains have exceeded their share of the national income. *Inter alia*, new taxes which fall especially on the well-to-do and an aggressive labor and farm policy account for the improved distribution. A continuance of these policies in peacetimes will assure the country a distribution of income which will be consistent with the maintenance of demand

and a workable capitalist system. Should deficiencies of demand, despite the new tax system, continue to jeopardize the attainment of our objectives, then the alternative of increased investment spending by the government must be faced.

With the advance of technology, we shall be able to produce the equivalent of our current income of goods and services with a much smaller amount of labor than is required now. The way is ours to choose, whether through a rise of output or an increase in leisure. The solution desired by the American people may be $150 billion of income and a 30-hour week; or $200 billion and a 40-hour week; or one of many other alternatives. It is hoped that a conscious choice will be made; the more leisure, the easier it will be to keep consumption at a sufficiently high level.

The contributors are all anxious that postwar economic policies assure the country a high level of employment and income and a fair distribution of the annual output. Most of the participants—though not all—have been influenced by the writings of Lord Keynes; they are, therefore, disposed to put much emphasis on the measures which must be taken to maintain demand, particularly the contributions to full employment of an improved distribution of income—and hence a rise of the propensity to consume—and public investment. These economists are impressed with the failure of the capitalism of the twenties to provide full employment and are impatient with economic theory that fails to discuss conditions of disequilibrium and underemployment. Keynesian influence will be especially evident in the parts of the volume devoted to the discussion of full employment and fiscal policies.

Proponents of public investment and policies directed toward increasing consumption and discouraging private saving in the postwar period are perhaps in the majority among the contributors. There are, however, several of the authors who disavow the approach through artificial increases of purchasing power and demand. Professor Schumpeter, for example, finds in the anticapitalist milieu a large part of the explanation of the attainment of what he calls "the oxygen-tent stage of capitalism." In his stimulating essay, deficit spending and the resulting heavy taxation are considered among the most serious deterrents of free enterprise. Proposing a destruction of monopolistic forces in our economy, Prof. Simons argues for a return to nineteenth-century liberalism. And Prof. Slichter finds in the high-wage policies encouraged by the rapidly

growing trade unionism a possible serious deterrent to private investment. Finally, the reader will find an able presentation by Prof. Ellis of the argument that recovery of international trade must stem from removals of restrictions to trade rather than from expansionist programs at home.

While differences among the contributors are to be expected, they must not be exaggerated. In general, the objectives of full employment, high productivity, equitable distribution of income, and removal of trade barriers are approved. The authors agree, well-nigh unanimously, that, if private enterprise does not provide a high level of employment and a reasonably high standard of living, government intervention is imperative. Capitalism is doomed if the experience of the thirties is repeated. There is general agreement also that, at least in some stage of the postwar period, renewal of foreign lendings, extension of our social security program, and improvement of our tax structure and public works programs of at least a temporary nature will be required.

SEYMOUR E. HARRIS
Editor

PART I

The Issue of Full Employment

CHAPTER I

THE POSTWAR ECONOMY

ALVIN H. HANSEN

ECONOMIC ADAPTATION TO A CHANGING WORLD

The Need for Flexibility in Public Policy.

Important structural changes in the world economic order grew out of the First World War. It is quite evident now that economic policy in the decade following that war failed to take adequate cognizance of these changes. Public policy was based too much on the assumption that one could act as though the economic order in its most fundamental aspects had changed not at all. It was a case of attempting to compress a changing world into the familiar molds of the prewar period.

Following the present war, it may be suggested, we are less likely to make this mistake. For one thing, the great depression has profoundly altered public opinion and no less the views and judgments of the leaders of public policy throughout the world. All history shows that the continuance of evolutionary progress in government requires a high degree of flexibility and adjustment to changed social forces; and that the effort to compress these forces into traditional molds produces, sooner or later, social and political revolution and economic chaos.

The current world conflict is not merely a conflict between nations. The disastrous experience of France makes crystal clear the fact that the Western world is passing through a period of high social tension produced by the tardiness of social and economic adjustment to change. The capacity of a nation in the modern, rapidly changing world to survive, without undergoing a revolution splitting wide open the foundations of the social structure, depends upon its power of adjustment, its flexibility, and its adaptability to rapid change. It is the peculiar genius of the British nation to evolve from old forms and institutions suitable adaptations to changed conditions. Elsewhere in the major European countries, it has not proved possible to relieve the

economic stresses and strains and the social tension by evolutionary adaptation, hence the revolutionary upheavals which have been witnessed to date in all the large countries on the European continent.

In the event of a successful war of moderate duration, say 2 to 5 years, there is, it seems to me, solid ground for believing that both in England and in the United States progress by evolutionary adaptation to change will continue. The same is probably true of the smaller countries of northern and western Europe. There is a growing recognition in these countries that the timid and negative policies of an outworn tradition are no longer applicable. There is a growing conviction that inventiveness and bold implementation are essential elements in any public policy which hopes to cope at all successfully with the world which will emerge from this war.

Full and Efficient Utilization of Resources.

The central goal and aim of economic policy are the most efficient full utilization of economic resources. What ends this efficient utilization of economic resources should serve is a question partly of ethical values and partly of social and political power, and these have certainly varied from period to period.

In the achievement of this goal the world failed most miserably in the two decades between the two world wars. The great industrial nations which control the bulk of the world's resources failed to make adequate use of these resources not only in the interest of their own people, but also (and indeed in large part because of this failure) in the interest of those peoples less adequately endowed with natural resources. Out of this failure sprang the breakdown of the world economy and political security.

Depressions a Danger to Free Enterprise.

One lesson stands out with great clarity from the experiences of the last two decades. It is no longer possible to accept the thesis that cycles of prosperity and depression may be complacently regarded as a characteristic of a system of free enterprise and private property. In the modern world no system can survive which permits the continued recurrence of serious depressions. Should it prove true, as some still argue, that periodic depressions are an inevitable concomitant of private property and free enterprise, then this system is doomed. I am not able, however, to accept the thesis that economic fluctuations cannot be controlled. The democratic

countries are committed, with the overwhelming majority view of their citizens, to the survival of a system of free enterprise. The successful pursuit of this ideal will be determined by the degree of success achieved in overcoming depressions and in reaching a substantial approximation to full employment.

Antidepression Policy.

It is just with respect to this problem of maintaining reasonably continuous prosperity and full employment that striking advances in public policy have been made. In the economic area these new implementations constitute in a significant sense the "arsenal of democracy." They are the only weapons that have so far been devised which give any promise of stopping, whatever the outcome of the war between nations may be, the advancing tide of a totalitarian economic order.

The basic political and economic institutions of our country, as we have known them, will, I think, survive. Yet in a real sense we are already in the midst of a transition to a new order. The mechanism remains substantially the same, but we are acquiring a new attitude with respect to what may be expected from this mechanism. In the past we have for the most part permitted the economic order to serve us as best it could on the basis of the automatic functioning of this mechanism. If it gave us good times, we were thankful. If it gave us bad times, we accepted this as an inevitable concomitant of a system of free enterprise operating under the price system. And we allowed the system itself to determine the distribution of the product and the direction of demand. Half of the population might be housed inadequately in terms of minimum standards of sanitation and health. If the automatic functioning of the mechanism did not create an economic demand for housing, houses necessary to meet those minimum standards were simply not built. A large portion of the population might be quite inadequately fed in terms of minimum nutrition standards. Yet despite the capacity of the system to supply an adequate nutrition standard, if the economic demand were not created through the automatic functioning of the system, nothing was done about it. We looked to the economic order to satisfy the needs, desires, and aspirations of human beings as conditioned by the process of innovation, education, and cultural development. But if those needs were not adequately satisfied, we accepted the result with a stern, ascetic fatalism.

Recent trends in economic analysis point to the conclusion that a more equal distribution of income would somewhat promote full utilization of productive resources. But we have as yet only the vaguest ideas about what the ideal distribution of income really means in concrete terms. We have perhaps made more progress with respect to minimum standards of consumption. There is rapidly emerging out of the experiences of the last two decades a conviction that we must deliberately set out to achieve new minimum goals. In the first place, we must enable all members of the community to enjoy the minimum food requirements necessary for an adequate nutrition standard. Secondly, the whole population must be supplied with public-health services and with hospital and medical care adequate to overcome preventable disease. Thirdly, we must implement ways and means to provide housing for the entire population adequate to ensure modern sanitation and health conditions and to afford living quarters commensurate with modern standards. Finally (and here we encounter an ideal with respect to which our country led the way a hundred years ago), we must provide minimum educational standards for our entire population, whether they happen to live in poor, backward states, or in the richer, advanced states, and in addition we must provide advanced educational opportunities for the highly gifted members of the community, without regard to the income class in which they may happen to have been born.

DEMOCRATIC PLANNING FOR FULL EMPLOYMENT

The fact is that many people dread to think of what is coming. Businessmen, wage earners, white-collar employees, professional people, farmers—all alike expect and fear a postwar collapse: demobilization of armies, shutdowns in defense industries, unemployment, deflation, bankruptcy, hard times. Some are hoping for a postwar boom. We got that after the First World War. Not improbably we may get it again. If the war lasts several years, we may have at the end of the war sufficient accumulated shortages in residential housing, in durable consumers' good such as automobiles, and in the plant and equipment required to supply peacetime consumption demands, to give us a vigorous private investment boom. Indeed, we need to be on the alert to prevent a possible postwar inflation. If in fact we do experience a strong postwar boom, there is, however, the gravest danger that it will lull us to

sleep. Sooner or later such a boom will end in a depression unless we are prepared. If appropriate action is taken, there is no necessity for a postwar collapse.

Everywhere one hears it said that, when this war is over, all countries including our own will be impoverished. This view is, however, not sustained by past experience. No country need be impoverished if its productive resources (both capital and human) are intact. The productive resources of this country will be on a considerably higher plane when this war is over than ever before. A larger proportion of our population will be trained to perform skilled and semiskilled jobs. We shall have enormous productive capacities in all the machine industries. And in special consumers' durable industries where plant and equipment may have become deficient by reason of the war, we shall be able very quickly, with our large basic machine-producing industries, to expand to meet the peacetime requirements. We shall have, when the war is over, the technical equipment, the trained and efficient labor, and the natural resources required to produce a substantially higher real income for civilian needs than any ever achieved before in our history. Whether or not we shall in fact achieve that level of income will depend upon our intelligence and capacity for cooperative action.

We have to make up our minds as a nation that we will not permit a postwar depression to overwhelm us. We do not have to take economic defeat after the military victory is won. We can, if we will, maintain business prosperity. We can sustain a continuing demand for goods. We can keep industry going at high levels. We can maintain substantially full employment. We can achieve a society in which everyone able and willing to work can find an opportunity to earn a living, to make his contribution, to play his part as a citizen of a progressive, democratic country.

An important gain will, we may hope, be won from the war program in the struggle to achieve and to maintain full employment. We have every reason to expect a national income of around $120 to $125 billion, in terms of 1942 prices. It will be much easier to muster support for a program to resist a decline from a high-income level than it has been in recent years to win approval for an adequate program to *raise* income to full employment from a low level. But we must be vigilant lest this gain slip from our grasp. If we let the income slide from $125 to $90, $80, $70 billion, we will have to make the old uphill fight all over again. We must

deliberately set out to hold the new income level and to push it higher as rapidly as increasing productivity will permit.

If purchasing power is maintained at a high level, we need have no fears that private manufacturers, retailers, wholesalers, and farmers will not come forward and supply the market with the goods demanded by the public—a rich variety of goods at reasonable prices. Private business can and will do the job of production. It is the responsibility of government to do its part to ensure a sustained demand. We know from past experience that private enterprise has done this for limited periods only. It has not been able to ensure a continuous and sustained demand. The ever-increasing gigantic powers of production of the modern industrial system, far exceeding those of any earlier experience in history, mean that an enormous output has to be reached before full employment is approached. Private industry and government together must act to maintain and increase output and income sufficiently to provide substantially full employment.

When the war is over the government cannot just disband the army, close down munition factories, stop building ships, and remove all economic controls. We want an orderly program of demobilization and reconstruction. The government cannot escape responsibility. To fulfill its responsibility it needs the hearty cooperation of business, labor, farmers, and the professions in the great task of developing a vigorous, expanding, and prosperous society.

A positive governmental program looking toward full employment would greatly vitalize and invigorate private enterprise. An expansionist program would permit private enterprise to operate at high output levels. There is plenty of work to do. We need improved manufacturing equipment to produce more and better goods at lower prices. We need to carry on extensive research in the laboratories of our great private corporations, in our universities, and in government bureaus to create new products and develop new processes. We need to rehabilitate and modernize our transportation system—by land, water, and air. We need continued advance in the techniques of production, distribution, and transportation; in short, in all those elements that enter into a higher standard of living. We need to rebuild America—urban redevelopment projects, rural rehabilitation, low-cost housing, express highways, terminal facilities, electrification, flood control, reforestation. Many public developmental projects open fresh outlets for private investment. We need a public-health program, including expan-

sion of hospital facilities. We need a nutrition program. We need more adequate provision for old age. We need higher educational standards in large sections of our country. We need a program to improve and extend our cultural and recreational facilities. We need an enrichment of the material and spiritual resources of our American way of life. We have seen how it is possible to mobilize the productive capacities of the country for war. We can also mobilize them for peace. Under a program of full employment new enterprises would grow up; old enterprises would expand. Youth would find opportunity and employment.

The notion that we cannot finance our own production is quite without foundation. Every cent expended, private and public, becomes income for members of our own society. Costs and income are just opposite sides of the same shield. We can afford as high a standard of living as we are able to produce. We cannot afford to waste our resources of men and material. We cannot afford to use them inefficiently. But we cannot afford idleness. The idleness of the decade of the thirties was responsible for the loss of $200 billion of income. The public expenditures required to rebuild America, to provide needed social services, and to maintain full employment can be provided for out of the enormous income which the full utilization of our rich productive resources (material and human) makes possible. The costs of producing this income are merely payments to ourselves for the work done. There is not—there cannot be—any financing problem that is not manageable under a full-employment income. In 1941 we produced a flow of final goods and services (net national income) valued at $95 billion. In 1942 it was about $120 billion. From an income so vast we can raise large tax revenues—large enough to service any level of debt likely to be reached and to cover all other government outlays—and still retain for private expenditures much more than we had left in former years under a $70 billion income with lower taxes. Taxes are merely one way of paying for social services and public improvement projects which we need. But it is not necessary or desirable under all circumstances to finance all public expenditures from taxes. Whether taxes should equal, fall short of, or exceed expenditures must be decided according to economic conditions.

Everywhere it is said, and constantly reiterated, that we must tighten our belts and pay off our government debt when peace returns. When is it desirable to pay off part of the debt? Certainly not when there is danger of an impending depression. Under

certain conditions it would be desirable to do so. Under other conditions it would be quite unsound policy to retire the debt. Financial responsibility requires a fiscal policy (including governmental expenditures, loans, and taxes) designed to promote economic stability. It would be quite irresponsible to cut expenditures, increase taxes, and reduce the public debt in a period when the effect of such a policy would be to cause a drastic fall in the national income. Equally it would be financially irresponsible to raise expenditures, lower taxes, and increase the public debt when there is a tendency toward an inflationary boom.

POSTWAR CONSUMPTION AND NATIONAL INCOME

In the calendar year 1941, expenditures on goods and services for private consumption amounted to $76 billion, of which about $11 billion were durable consumers' goods, such as automobiles and household equipment of all kinds. In 1943, purchases of consumers' durables will be cut to a minimum. Total consumption purchases for private use may have to fall to $70 or even $65 billion in order to provide adequate resources of equipment, raw materials, and man power to produce the $90 billion needed for the war. Thus the various components of the 1943 national product may be set down as follows:

COMPONENTS 1943 GROSS NATIONAL PRODUCT
(In billions)

Private consumption	$ 78
Nonmilitary government services (adjusted)	12
Private capital formation (including replacement)	0
War (including war materiel, outlays for plant, equipment, and lend-lease)	90
Total gross national product	$180
Less business taxes and corporate gross savings	45
Net national income	$135

When the war is over and the $90 billion expenditures for war are drastically curtailed, we shall be confronted with a gap that has to be filled by consumption and capital formation if we are to maintain full employment.

We have assumed that consumption expenditures would be held down to $78 billion for the year 1943. It is not likely that this could be achieved without (1) the imposition of heavy income and consumption taxes during the war effort, (2) part payment of the increased wage and salary bill in defense bonds (Keynes's plan),

and (3) large voluntary purchases of defense bonds. If these ends can be achieved *during* the war period, the postwar release of funds thus diverted would help greatly to raise postwar consumption and so fill part of the gap from curtailment of war expenditures.

In the postwar period, the problem is how to fill the gap left when war expenditures are curtailed. Let us suppose the following components of the postwar national product:

POSTWAR GROSS NATIONAL PRODUCT COMPONENTS
(In billions, and at 1942 prices)

Private consumption	$100
Private capital formation	22
Government purchases of goods and services (including the ordinary services of federal, state, and local governments, military expenditures, public works, etc.)	38
Total gross national product	$160
Less business taxes and corporate gross savings	35
Net national income	$125

This model presupposes that private consumption will have been lifted from about $75 billion in 1943 or 1944 to $100 billion in the transitional postwar period. In the immediate postwar transition, the increase in consumption might come (1) partly from the full cash payment of wages and salaries in lieu of the assumed partial payment of wages and salaries in defense funds during the peak of the war effort; (2) partly through the conversion of the accumulated defense savings into cash by selling the defense bonds to banks or to individuals desiring to save and the expenditure of such sums on durable consumers' goods with respect to which, in all probability, a large backlog of deficiencies will have accumulated during the war period; (3) partly through an expansion of consumers' credit which we may assume will have been reduced to small proportions during the war period; (4) partly through a sharp reduction of the taxes imposed during the war period on liquor and tobacco, together with the complete abolition of severely regressive consumption taxes on necessities; (5) partly through a shift (especially in the middle- and upper-income classes) from the purchase of defense bonds to enlarged consumption expenditures, especially on durable goods; and (6) partly through an enlarged program of Federal expenditures on social welfare, including (*a*) family allowances, (*b*) food-stamp plan and other food subsidies designed to improve nutrition, including school lunches, (*c*) greatly enlarged public-health program, (*d*) revised and expanded program for old-age

assistance and old-age pensions, and (e) Federal aid to education to bring up the standards in backward areas.

The model further assumes a considerable increase in capital replacement and a corresponding reduction in business taxes. Gross private capital formation, including replacement expenditures and net additions to capital, are estimated at $22 billion. This includes inventory accumulations and investment in plant and equipment and in residential buildings. All these areas may have been starved during the defense and war period, and, accordingly, large shortages may have accumulated requiring greatly increased capital outlays. Capital expenditures might well, for some years, rise to a level above the figure indicated. After the First World War a tremendous spurt occurred, lasting from the spring of 1919 to the middle of 1920, in investment in manufacturing plant and equipment.

Altogether the various factors enumerated above indicate the great possibilities for the expansion both of consumption and of private investment during the transitional period. Indeed, the potentialities for expansion of consumption and private investment in the immediate postwar period are sufficient to indicate the possibility of a genuine and fairly prolonged postwar boom. The Federal government should, however, be prepared to play a balancing role, checking any temporary tendency toward an excessive boom, and, on the other hand, be prepared to go forward with large Federal expenditures on public improvement projects to compensate for any strong tendency toward deflation and depression.

Shift toward a High-consumption Economy.

From the long-run standpoint, a persistently pursued policy to maintain full employment raises interesting questions with respect to the effect of such a policy on (1) the distribution of income and (2) the proportion of a full-employment income which, it may be expected, would be expended on consumption. In brief, it is reasonable to suppose that the ratio of consumption to income in a full-employment economy would automatically tend to be higher than the ratio of consumption to income at the peak of a boom in a violently fluctuating economy. A full-employment economy would tend automatically toward a distribution of income favorable to high consumption. This affords ground for optimism with respect to the feasibility of a positive program designed to maintain full employment. Such a policy, if successfully pursued, tends to

develop repercussions upon the distribution of income which reinforce the program to maintain full employment.

That this is true can best be seen if we analyze the problem of corporate profits in a society continually operating at a full-employment level. Peak prosperity profits have never in the past been realized for any considerable period of time. In a highly fluctuating society such as we have known, normal profits are some sort of average of good times and bad times. Thus, for example, in the period 1925–1940, the net income of corporations fluctuated very violently in relation to the total national income. In periods of high prosperity, the ratio of net income of corporations to the total national income was high, while in periods of depression, despite a fall in the national income, the ratio of the net corporate income to the total national income was low. Over the entire 16-year period from 1925 through 1940, inclusive, the corporate net income averaged only 4.6 per cent of the national income. It should be remembered, moreover, that this 16-year period included many years of serious depression, so that the average national income was relatively low. In other words, corporate profits constituted only a low percentage of a small national income—small in comparison with the income potentially realizable.

In a highly fluctuating society, corporate profits are high in good times and extremely low in bad times, but the average must be adequate to motivate a profit economy and ensure its workability. If, however, it were possible to maintain continuously a full-employment national income, it is obvious that corporate profits, representing the same percentage of national income as that averaged over the cycle in the past, would yield an absolute profit figure far above the experience of 1925–1940. Yet such a percentage continuously maintained would be much lower than the high ratio of profits to national income reached in a fluctuating society in the peak boom years.

In a society operating at continuously full employment, it is not probable that peak-prosperity profits (in 1925–1929 approximately twice the average for the entire period 1925–1940) could indefinitely be maintained. In a fluctuating society, such high profits are necessary to offset the losses of the depression years, but it is unreasonable to suppose that profits of the magnitude of boom periods would be realized indefinitely in a full-employment system. They would almost certainly be eaten into, partly by competitive price decreases benefiting consumers and partly by the pressure for

higher wages which invariably occurs in industries making large profits. Either development would tend toward a more equal distribution of income than has prevailed in the past *in boom periods* when full employment was reached. This is true because of the relative decline in the ratio of business profits to the national income *at full-employment levels.* Yet, if a full-employment income were continuously maintained, the ratio of business profits to the national income over the whole cycle would probably be greater than that experienced in the past, while the *magnitude* of business profits would be considerably greater, owing partly to the higher average ratio and partly to the higher average national income for the whole period.

It must be recognized, however, that there are certain limitations on how far profits can be encroached upon, either through wage increases or price decreases, without encountering unfavorable economic repercussions with respect to the cost-price structure. Wage increases and price reduction are likely to cut across all firms in an industry, whether they make profits or not; and wage increases are likely to spread even to industries which are not making abnormally large profits. Thus, the process of encroachment upon boom-time profits through wage increases and price reduction, if carried too far, may disrupt the appropriate balance in the cost-price system.

Redistribution of income through progressive individual and corporate income taxes is less disruptive of these relations for the reason that such taxes apply only where the profits and income actually emerge. They do not affect the high-cost industries which make no profit. As already indicated, there are limitations upon the process of redistribution of income through the methods of wage increases and price reduction. These methods are feasible up to a certain point, but the point is fixed by the requirements of cost-price balance.

Consumption can, nevertheless, be very materially raised through wage and price adjustments in a society continuously maintaining full employment. There would still remain, by reason of continuous capacity output, adequate profits to sustain and motivate private enterprises—indeed better profits than those experienced on the average in a highly fluctuating society.

Such a shift evolving gradually could add several billions of dollars per annum to consumption expenditures at full-employment levels. In addition, continuing improvement in labor productivity

as a result of technical progress would make possible progressive wage increases without encroaching on the necessary profits required to motivate a private-enterprise economy.

In a later postwar period, following the transitional readjustment, we may assume a gradually increasing national income. In terms of current prices, $135 billion of national income by 1943 or 1944, as indicated above, is probable. Accordingly, it should not be unreasonable to suppose that, by reason of (1) increased productivity and (2) population growth, the national income might rise to around $150 billion by 1950.

The components of such a national income, for illustrative purposes, might be set down as shown in the following table:

COMPONENTS OF THE GROSS NATIONAL PRODUCT, 1950
(In billions)

Private consumption	$120
Private capital formation	25
Government purchases of goods and services	40
Total gross national product	$185
Less business taxes and corporate gross savings	35
Net national income	$150

Conclusions with Respect to Policy.

Obviously, the income models set down above can have no validity as statistical forecasts. They are useful, if at all, only as aids to analysis and formulation of policy. They suggest certain conclusions.

First, with respect to the war period, the following policies are indicated:

1. High corporate-income and excess-profits taxes.
2. Sharply progressive estate taxes.
3. Broadening of individual income-tax base together with steeply graduated surtax rates.
4. Sharp increase in excise taxes on commodities competing with the war program.
5. Part payment of wages and salaries in war bonds.
6. Qualitative shift in the components of consumption.

Second, with respect to the postwar period, the following policies are suggested:

1. Retention of progressive (graduated) tax structure and broadened tax base, with major emphasis on the individual income tax and less reliance on the corporate income tax.

2. Sharp reduction in war consumption taxes.

3. Adequate plans by private enterprise for private-investment projects in manufacturing plant and equipment, in railroads, public utilities, and housing.

4. Adequate program of public-improvement projects, including a nationwide development of national resources, express highways, urban redevelopment (involving among other things outlays in terminal facilities and reorganization of urban transportation), and a reorganized public housing program (including the setting up of a Housing Research Laboratory designed to reduce construction costs and thus enlarge the scope of private housing construction).

5. Expansion of public-welfare expenditures—Federal aid to education, public health, old-age pensions, and family allowances. This involves partly an expanded program and partly a means of reducing state and local property and consumption taxes, thereby stimulating private consumption expenditures.

6. International collaboration to pursue internal policies designed to promote active employment; to explore developmental projects in backward countries; and to implement ways and means to open outlets for foreign investment, and to promote world trade and the effective worldwide use of productive resources.

POSTWAR DEVELOPMENT PROGRAM

A fatal defect in New Deal spending of the thirties was its hand-to-mouth character; no one knew where it was going or when it would end. What is needed in the postwar period is a program conceived in terms of a decade or more, so that private business can plan its investment program on a secure basis. The investment plans of private business are determined in considerable measure by national income. If businessmen expect a fluctuating national income or a prolonged depressed income of $60 or $70 billion, their investment plans will be pitched to this level. However, if a comprehensive long-range development program has been prepared and presented to the public—a program that assures a continued high level of employment and income—business investment plans will be pitched on a quite different level. Sporadic public expenditures, no matter how large, will induce little or no private investment, but a public-development program extending over many years and designed to open private investment outlets could profoundly influence investment decisions.

Such a program must be conceived in bold terms. A timid policy that demands the full return of 100 cents on every dollar invested is quite inadequate. It should be recognized that many public-development projects are justified from the standpoint of the economy as a whole, even though they might return directly to the Treasury only 50 cents on the dollar. The Tennessee Valley Authority, for example, may not return 100 cents to the Treasury for every dollar expended; nevertheless, in terms of the increased productivity in that area and indirectly in the nation as a whole, it is an immensely profitable venture.

A comprehensive economic development program should be nothing short of a plan to rebuild America over the next two decades, to develop her latent resources, to increase her productive power, and to raise her standard of living and purchasing power. It requires a planned development in the following six areas:

1. *Urban Redevelopment.* Of first importance from the standpoint of living conditions and in terms of the magnitude of induced private investment is a program of urban redevelopment. The need for extensive replanning and rebuilding of American towns and cities is urgent. Their physical layout no longer meets the requirements of modern conditions. Problems of traffic congestion, transportation terminals, overcrowding of population, slums and blighted areas, parking space for motor vehicles, and space for recreation have been met only with piecemeal palliatives. Great and ever-widening areas around the centers and subcenters have become blighted. Suburbs have grown in all directions and, consequently, the metropolitan center has lost in taxpaying capacity. In blighted areas, tax delinquency has become an acute problem. Redevelopment is prevented by the burden of excessive land-acquisition costs.

An adequate program of urban redevelopment is so great an undertaking that Federal aid would have to be substantial. With the cooperation of the states, Washington should set about removing the two chief obstacles in the way of replanning and rebuilding. These obstacles are legal—the lack of adequate powers of the local governments to control the use of land—and financial—the frozen status of high land costs and the fiscal incapacity of the local units of government.

Each city or group of contiguous cities should be required, after the states have granted the necessary legal powers, to produce a satisfactory master plan for the entire metropolitan area. The

Federal government through an appropriate Federal agency would then be asked to advance a substantial part or all of the funds with which the real property in the slum and blighted areas would be acquired. It would be repaid as far as possible out of subsequent proceeds from the use of land.

The master plan would indicate the proposed use of every portion of the acquired area. Use would be determined without regard to acquisition cost. Part of the land doubtless would be available for business and industrial use, a part for parking space and for playgrounds, but the largest part would be set aside for residential purposes. A part of the new housing thus developed would be public low-cost housing, but the greater part of it can, if proper steps are taken, be undertaken by private enterprise.

A many-sided attack upon the housing problem requires first a rationalization of the construction industry. A research and experimental agency endowed with adequate capital, say $50 million, should be set up to solve on a full commercial scale the problem of producing good low-cost dwellings. In addition, private investment in houses for rent by life insurance companies, savings banks, trust estates, foundations, and other holders of savings should be stimulated by an amendment to the National Housing Act authorizing the Federal Housing Administration to ensure recovery of substantially all the original investment and a minimum annual return of say 2 per cent for a period of something like 30 years. Under this program, the entire property would be held by the owner, mortgage free. Thus far, only one important life insurance company has done anything in the way of building large rental properties on an unencumbered-ownership basis. A minimum guaranty by the Federal Housing Administration probably would induce a much larger development of rental housing properties.

2. *River-valley Development.* A program of river-basin development looking to the best use of our water resources is imperative. In many river basins, this involves multiple-purpose projects, including navigation, flood control, the development of hydroelectric power, irrigation, drainage, and soil conservation. The American public finally has accepted with favor the gigantic experiment in the Tennessee Valley. Bills now before Congress call for somewhat similar developments in the Columbia River Basin in the Pacific Northwest, and in the Arkansas River Valley. All told there are perhaps 20 or 30 river basins throughout the country that need development, some suitable for multiple-purpose development,

others of a more limited character. A plan of river-valley development for the entire country should be made as rapidly as possible, since adequate blueprinting of the development of our water resources will require a vast amount of technical research.

3. *Railroad Investment Program.* Our railroads sadly need modernization of equipment and integration of organization. The country's entire railroad system probably ought to be organized into a few railroad companies, each covering a special region. The mess of overlapping and conflicting securities needs to be swept aside. Private operation and management can continue, but the right of way and terminal facilities should be government-owned. Under such a program, the Federal government would be able to go forward in periods of business slump with investment in bridges, underpasses, terminal improvements, and similar fixed capital investments.

4. *Interregional Highways and Air Transportation.* The Bureau of Public Roads is making studies of interregional and express highways with appropriate connections through and around the great metropolitan centers. Improved and modernized road facilities are especially needed to solve the problem of city street congestion and to facilitate rapid transportation between major metropolitan areas.

Following the war, we can expect a tremendous acceleration of air transport. This development undoubtedly will include not only express and freight transportation but also private flying and a great enlargement of passenger transport. Provision must be made for adequate airports, terminal buildings, and hangars. Transit facilities must be provided to permit easy access to the cities so that the time saved by plane will not be lost at the terminal. An extension of the airway system will require the establishment of large milages of beacon lights, markers, and communication equipment. Such public improvements are the necessary basis for the development of a potentially important industry.

5. *Rural Development Projects.* The Department of Agriculture has long considered the development of large-scale rural public-investment projects. Many of these are already under way, but expansion of the program is necessary. This involves an acceleration of the program of rural electrification, a greatly expanded program of reforestation and soil conservation, and an adequate program of rural housing.

6. *Federal Work Reserve.* The Federal Works Agency is currently engaged in a nationwide project to build up a large postwar

"shelf" of public work projects. These involve mainly the more familiar types of public works, including roads and bridges, harbor development, canals, water-supply and sewerage disposal facilities, welfare and health institutions, such as hospitals, prisons, and community recreational centers, schools and government office buildings, experiment and research stations, and public low-cost housing.

A program along the various lines indicated above is essential if we are to face the future with any assurance of the continuance of substantially full employment and as rapid a rise in real income as technical progress will permit. We need a new spirit of enterprise to develop the resources of the country as a whole and of backward areas in foreign countries. We need boldly and fearlessly to implement the government as an instrument of economic expansion, as was done in the early part of our history.

A comprehensive development program does not require the government to preempt any large segment of the economy. Over 85 per cent of the economy is normally devoted to the production of consumption goods. Under modern conditions, to be sure, important services included in the consumption category are performed by government, but the proportion to the total consumption of goods and services is small. Private manufacturers, retailers, wholesalers, and farmers can supply the market with the goods consumers want. Moreover, the bulk of investment can be undertaken by private enterprises. Public investment and development projects are needed especially in those areas where there is no assurance that direct returns will bring 100 cents on each dollar expended, but where from the standpoint of the general economy the undertaking can be justified. A comprehensive developmental program would act as a wedge to open private investment outlets. It would raise employment and national income, and thus indirectly stimulate the volume of consumption expenditures. It would raise the standard of living and invigorate private enterprise both in the consumption and in the investment spheres.[1]

[1] Much of the material in the foregoing chapter is drawn from the following previously published writings of the author:

Alvin H. Hansen, "Changes in Economic Structure Arising out of the War and Their Implications for Public Policy," Ch. IV, Part III, in *Public Policy*, Vol. III, C. J. Friedrich and E. S. Mason, eds. Cambridge, Mass., 1942.

Alvin H. Hansen, *After the War—Full Employment*, National Resources Planning Board, 1942.

Alvin H. Hansen, "Our Coming Prosperity," *Common Sense*, June, 1942.

Chapter II

FULL EMPLOYMENT AFTER THE WAR

Paul A. Samuelson[1]

As this essay is written, America's most important task is that of winning the present conflict. Therefore, the difficult problems which our economy must again face when peace is at last reattained have very properly been pushed into the background. The most important of these problems is that of providing for *continuing full employment.* Before the war we had not solved it, and nothing that has happened since assures that it will not rise again. And yet it is vitally important that we win victory on this economic front. Not alone for the tremendous material advantages which full employment will bring, but also because politically a democracy cannot flourish under conditions like those of the great depression.

It is necessary to emphasize these simple fundamental facts because in the years just prior to 1939 there were noticeable signs of dwindling interest in the problem of unemployment, which took the form of ostrich-like attempts to "think" away the very fact of unemployment by recourse to bad arithmetic and doubtful statistical techniques. And even among professional economists there was increased emphasis on the recovery of production and income to 1929 levels.

At the present time, there are clear indications of increasing optimism among our better informed observers concerning the likelihood of a postwar boom of some duration. In this respect, the experts are far ahead of the business community and the man on the street; but those who take the pulse of public opinion profess to detect some signs of increased optimism even among these groups.

[1] The lay reader may find parts of this essay difficult reading. The excellent summary herein of some aspects of Keynesian economics—which is the basis of much of the reasoning in this volume and to which Prof. Samuelson has made contributions—should be read carefully, for without an understanding of this material one cannot understand the problem of unemployment and its relation to savings and a rising standard of living.—Editor

No doubt this is a healthy corrective against the undue pessimism concerning the postwar period which characterized public opinion in the recent past. But it would be unfortunate if we were to build up an attitude of complacency which might inhibit constructive policy formation designed to promote effective demand and combat unemployment should it develop; unless, of course, facts have become available which show conclusively that a lasting postwar boom is indeed inevitable. This essay will be concerned with weighing the strategic factors and considerations upon which the validity of this point of view depends. However, it may be said in the beginning that whether optimism may or may not be justified, complacency certainly cannot. Precision in forecasting is simply out of the question. There exists no new facts, secret or otherwise, which can justify the relaxation of our vigilance or of our conviction to combat a downward spiral of income and employment.

SIZE OF THE PROBLEM

By this I do not mean to imply that there is a serious prospect that we shall return to national income levels such as characterized the deep depression of 1932–1933. Regardless of plans and intentions, any party in power would be forced by the mere sweep of catastrophic political events to provide sufficient demand to prevent this from happening. The real danger lies in the possibility that we shall lag ever farther behind our true productive potential—that we shall be content with a half loaf instead of insisting upon the whole loaf which can be ours. The thing to fear is an ever-widening gap between our attained levels of output and employment and our true productive potential.

It has taken the heavy wartime expenditure to show us how big the gap already is. Throughout the thirties productivity increased tremendously so that we were able to reach the 1929 levels of real income with considerably reduced employment. Until the defense program, all these gains plus the whole of our population increase were dissipated in unemployment or shared underemployment. Any doubts as to the magnitude of this dissipation are removed by the fact that we are currently producing real national incomes 50 per cent greater than those of 1929.[1] Given time in

[1] It is not certain but what our current peacetime potential would be greater than that now attained. For war products must be produced hurriedly and in the face of bottlenecks, with shortages of strategic metals and with equipment not completely adapted to the changed character of production. In addition, some millions of able men are taken by the military forces

which to make adaptations of equipment and manpower, it is only conservative to estimate that by the middle of this decade we shall be able to produce real national incomes 50 per cent greater than *prewar* levels; and by the closing years of the decade, real national incomes more than 70 per cent greater than *prewar* levels. In terms of *1935–1939 dollars* this means net national incomes of around $110 billion and $120 billion respectively.[1]

However, there is no special reason to believe that we shall necessarily return to prewar price levels. Indeed, despite our best efforts to control the price level by fiscal and direct measures, he would be an optimist who did not allow for at least a 25 per cent increase over the price levels prevailing in the summer of 1942. Consequently, within little more than the next half-dozen years, we may witness money national incomes of not much less than $170 billion.[2] Such a figure may seem fantastic, but so have all the estimates of one or two years ago—estimates which have already proved to be too cautious. Furthermore, our figure is premised upon the successful maintenance of full employment. And if events prove the estimate to be excessive, no harm will have been done since it will simply bring home by exaggeration the qualitative nature of our problem.

In drawing up fiscal plans for the future we must begin to think in larger numbers. Out of $170 billion income we shall have more money to spend on food, clothing, housing, recreation, leisure, education, saving, and personal security. We shall also be able to afford more in the way of public works, urban reconstruction, social

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at fractions of their previous incomes. Against these factors must be mentioned the increased intensity of work under multiple-shift operations and the fact that national income figures are swelled by the less prudent expenditure of funds which the emergency necessitates. The incommensurability of war output makes it impossible for statistical deflation of money income to remove the latter source of bias.

[1] These figures are offered with due allowance for apparent productivity trends and population changes. Needless to say, they imply no forecast and are introduced only for purposes of exemplification. If anything, they are probably too low.

[2] Most of the rudimentary caculations that are presented in this essay are independent of the price level in terms of which real magnitudes are expressed. Should the increases in productivity upon which all the above estimates are based *lower* prices below the hypothesized levels, only a scale change in the value of various magnitudes will be required. An exception is provided by the case of such fixed-money magnitudes as the national debt. Changes in the price level will then mean real changes in its "burden."

security, welfare expenditures, etc. And by hypothesis only a small part of the increase in our total disposable money income will be offset by the higher prices for which everything will sell.

This is the promise which the future holds for us, provided that we are lucky or provided that we manage our affairs well. But bitter experience of the last dozen years, if not of the last century and a half, shows that there is no invisible hand guaranteeing that we shall always be lucky. Whether or not we should prefer it that way, the only alternative is deliberate, purposive, intelligent social action on whatever scale is necessary to ensure continuing full employment.

PROBLEM OF EFFECTIVE DEMAND

Anyone with the slightest knowledge of the existing standard of living of the various economic groups in our economy, and of the want patterns characteristic of modern society, cannot doubt that our *needs* will not begin to be filled by a 70 per cent increase in output, nor even by a doubling and quadrupling of output. We may take it as axiomatic that within the visible range human wants are insatiable, so that we shall not lack for employment for the reason that there is nothing useful left to be done.[1]

Why then can there be any problem of unemployment? A few of the older economists might even have denied its possibility on the basis of a discussion of human needs. But these would be in the minority. Bitter experience has taught us that it is not enough to be able to produce and to be able to consume. Demand must become effective if those who are willing to work are to find employment. At the bottom of the great depression our wants were if anything greater than before, our abilities to produce no less, and yet there was no mechanism by which these could be brought together.

It is not possible to reach full agreement among economists on any subject, much less on the fundamental reason why the above paradox should prevail. But increasingly there is a trend toward a theory of income determination, such as is about to be described.[2]

[1] In that dim distant (and probably ever-receding) day when human wants are satiated, the alternative to work will not be enforced unemployment, but rather play and leisure, *i.e.*, activity undertaken for its own sake.

[2] To a first approximation, with given technology and capital, the level of employment is determined as soon as the level of income is given, increasing as the latter does. This is not exact because the same level of income can be

It is associated largely with the name of John Maynard Keynes, although others have aided in its development. While its crystallization can be dated from the appearance of the *General Theory*[1] in 1936, it can be shown to have its roots in the earlier thinking of Keynes and other economists, and also to represent an amusing "throwback" to discredited doctrines of earlier days. Although the appellation "Keynesian" is usually applied to individuals of a certain viewpoint with respect to monetary and fiscal policy, this should not be confused with the use of the term as applied to those economists who use the technique of analysis which is about to be described. In itself the technique of analysis is neutral on policy questions, and that is why a majority of modern economists can continue to employ it while still dissenting vigorously from the views of the small but growing minority who constitute the inner circle.

THE SAVING-CONSUMPTION-INCOME PATTERN

We may approach our problem by way of an investigation of the manner in which an individual family expends an increase in its income of, say, 10 per cent.[2] Its expenditure on each item purchased does not ordinarily go up in the same proportion. Despite some shifts to better grades of food, its total expenditure on food will in all probability increase by less than 10 per cent. On the other hand, its expenditure upon recreation may increase by more than 10 per cent. But if all consumption items are added

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weighted more or less heavily with products requiring much or little labor per unit. But for the present purpose it will be satisfactory to regard employment as being determined as soon as income is determined.

[1] J. M. Keynes, *The General Theory of Employment, Interest, and Money* (London, 1936).

[2] Literally thousands of "budget" studies have been made of income patterns in different countries and cities. *Cf.* Faith M. Williams and C. C. Zimmerman, *Studies of Family Living in the United States and Other Countries*, (U. S. Department of Agriculture, Publication 223). The consistency of results is impressive, suggesting that here we have a fairly stable and fundamental relationship. One of the most complete studies ever made for a country as a whole is outlined in *Consumers Expenditure in the United States*, 1935–36 by the National Resources Committee. This one undertaking represented the joint work of the above committee, the Bureau of Labor Statistics of the Labor Department, the Bureau of Home Economics of the Agriculture Department, and the Works Progress Administration. Despite inevitable inadequacies, it has rightly come to be regarded as a basic social document.

together, it is almost invariably found that they increase in smaller percentage than income; that those families with higher incomes devote an increasing percentage of their income to saving, *i.e.*, to the purchase of securities, life insurance, or to the accumulation of saving accounts. Even more certain is the generalization that *with higher incomes, some fraction of the increase goes into saving so that the total of saving increases absolutely with income whether or not it does so in less or greater proportion.*

In view of the relationship between family savings and family income, it is to be expected that there should be a fairly stable relationship between the total of all family savings and total national income; or what is only the other side of the picture, between total consumption and national income. Examination of the data provided by the painstaking efforts of Prof. Simon Kuznets of the National Bureau of Economic Research shows this to be the case.[1] For when national income rises, the incomes of most groups do also, and if not in the same proportions, nevertheless in a pattern sufficiently regular as to lead to the same result.

To individual and family savings we must add the savings of business and corporate enterprise. Indeed, it would appear from statistical examination that although these sources provide only a fraction of total saving, nevertheless they provide almost the whole of *extra* savings made out of additions of national income. Their so-called *marginal propensity to save* exceeds that of individuals.

Statistically, theoretically, and institutionally, everything points toward a consumption-savings-income pattern which is relatively stable, which is qualitatively predictable, and which changes only slowly over time. At low levels of national income net savings are negative; at some intermediate break-even point considerably below the full-employment level, they are zero; as we approach full employment, they mount rapidly, increasing more than proportionately with income.

[1] S. Kuznets, *National Income and Its Composition*, 1919–1938, Vols. 1 and 2 (New York, 1941). The interested reader may also refer to the following statistical investigations: A. H. Hansen, *Fiscal Policy and Business Cycles* (New York, 1941), Ch. XI and Appendix; M. Ezekiel, "Saving, Consumption, and Investment," I and II, *American Economic Review*, March and June, 1942; O. L. Altman, *Saving, Investment, and National Income*, T.N.E.C. Monograph 37; M. Abramovitz, "Savings and Investment; Profits vs. Prosperity?" *American Economic Review*, Supplement, June, 1942, pp. 53–89. R. Bangs, "The Changing Relation of Consumer Income and Expenditure," *Survey of Current Business*, April, 1942, pp. 8–12. For other countries, the reader may consult C. G. Clark, *The Conditions of Economic Progress* (London, 1940).

As a second approximation to bring the picture into greater conformity with reality, we must modify the above notion of a stable consumption-savings-income pattern to allow for *secular* and *cyclical* alterations. The first is most easily understood. As real income increases over time, commodities that were once luxuries become necessities. Today, modest incomes can buy more than a king's fortune could command in former times. And yet such incomes are often not large enough to finance "absolutely necessary" purchases, so that their possessors cannot break even, much less save on balance.

What is true for the individual is true for the community. Whatever the concept of oversaving is supposed to mean, it certainly does not imply that at the same levels of real income modern communities consume less than they used to. Rather is the reverse true. Not only does consumption at the same income levels increase secularly, but our rudimentary statistical data indicate that in each decade for the half century prior to 1929 about the same percentage of national income was saved.[1] Since national income was increasing rapidly throughout this period, the most plausible explanation of this is to be found in the hypothesis that our enlarged scale of wants was causing an upward shift in the consumption function at about the same rate as improvements in our production potential, yielding a stable relation between percentage consumed out of national incomes corresponding to a given fraction of *full-employment* income.

Indeed, were it not for this upward shift of consumption, it would have become increasingly difficult to approximate as closely to full employment as we have in the past. And in the future, the outlook for employment would be very black if we could not count upon expanded standards of life. But this is not to imply that there is any guaranty that the upward shifts of the consumption schedule will be at a rate rapid enough to keep up with our productive potential; especially if the war and a prolonged period of depression keep us from knowing what we are missing in the way of new good things of life, so that our consumption "requirements" increase more slowly than our productive potentialities.

[1] S. Kuznets, "Capital Formation, 1879–1938," *Studies in Economics and Industrial Relations* (Philadelphia, 1941), pp. 53–78.

The customary relation is not to be found in 1941 and 1942 when restrictions on flows of consumers' goods and patriotically induced subscriptions to war bonds stimulated savings.—EDITOR

has been drawn so that at each peak of the cycle, assumed for simplicity to correspond to full employment, about the same percentage of total income is consumed. This can be seen from the fact that the upper right-hand "corner" of each spiral falls almost on the dotted straight line through the origin.[1]

I have dwelt at some length on the behavior of consumption and savings in relation to income because this relationship is crucial for all business-cycle theories and provides the setting within which all analysis must take place.[2] At high levels of income corresponding to full employment, billions of dollars will be saved every year.[3] These sums are saved each year because people have incomes in excess of their consumption needs, because of a desire for personal security, because of power considerations or greed, because of automatic institutional arrangements, and for a thousand other reasons. It is irrelevant whether the process is deliberate or unconscious, whether prudence and thrift are involved or greed and lust, whether or not there is pain and abstinence. The desire to accumulate is a social *fact*, to be taken as such. And whatever might or might not be true of a Robinson Crusoe economy, it is clear that in modern societies individuals save regardless of the magnitude of investment outlets. Even if no new securities were floated, attempts to save would continue; and if old securities were not avail-

[1] Some might choose to interpret the dotted line as a very long-run consumption function, although I myself would not. Even if regarded as such, the fact that it does not show an increased percentage of saving as income rises does not in any way vitiate the application of the usual saving-investment analysis. It is necessary to emphasize this because in some quarters Prof. Kuznets' historical findings are taken as disproving the Hansen-Keynes long-run analysis.

[2] My omission of a discussion of the effects of interest rates and of stocks of wealth upon savings is a reflection of my belief, which cannot be justified here, that these are relatively minor in importance.

[3] If the 1935–1936 expenditure patterns and the 1935–1936 *relative* distribution of income were maintained, *real net savings* expressed in prewar dollars might be as large as $22 billion. In then current dollars this might be $28 billion. To this must be added some billions of net corporate saving, giving total net saving of around $32 billions. If a gross figure is desired, some further billions of depreciation must be added. Furthermore, in recent months it has become customary to distinguish between net national product and the total value of national expenditure valued at final prices. The latter magnitude exceeds the former by the amount of indirect business taxation. *Cf.* Milton Gilbert, "War Expenditures and National Product," *Survey of Current Business*, March, 1942, pp. 9–16. A comparable figure for saving could be derived by blowing up ours by some percentage.

able, it would still be possible to accumulate noninterest-bearing assets such as cash.

It is important to emphasize the stability of the savings-income pattern because of the insight it yields into historical income determination. Yet it is also important to remember that this pattern can be modified by *deliberate social action.* This does not mean that "Buy now" campaigns will end a depression, nor that exhortations to acquire government bonds will end a wartime inflation. However, by appropriate changes in our personal and corporate income taxes, we can affect the distribution of final disposable income in terms of which saving decisions are made. But such action must dig deep, for the institutions and habits relating to saving lie deep in our economic and political organism.

NECESSITY TO OFFSET SAVINGS

Aside from deliberate social action modifying the distribution of income, there does exist one process which is an effective regulator of the supply of saving. Precisely because of the stable income-saving pattern, declines in national income will make the community so poor that it will not save at all, or will dissave. For upon one thing all modern economists, of whatever school of thought, are agreed: *the amount which the community wishes to save at full-employment income levels must somehow be offset, or income will fall until the community is so poor and wretched as to be willing to save no more than can be offset.* In terms of time-period analysis, the community must return to the income stream in each period as much as it received in previous periods, or else there will ensue a cumulative downward spiral of income and employment.

We are confronted with the paradox that while no one attempts to save with any thought of investment outlets or of offsets, yet the amount which all together succeed in saving is brought into alignment by the movements of income and employment. But the alignment is performed on a cruel Procrustean bed, with employment and income being lopped off if the desire to save is excessive in comparison with available offsets, and with an inflationary straining of demand if investment is excessive.

It is important to understand this process because it throws light on countless other paradoxes. It is not that effective demand is independent of economic law. On the contrary, no view could be more fallacious than that which regards a depression as simply the result of a vicious spiral of unfortunate circumstances which, if

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once set right, would usher in permanent full employment. Many times during the thirties we had incipient boomlets; if only optimism and an upward start were needed, they would never have come to an end. But today we have come to understand that a system may be in *stable* underemployment equilibrium. Economic law is operative but in a non-Euclidean, or rather a non-Ricardian, world in which the "topsy-turvy" may be right and the plumb line may be crooked. It is characteristic of such a world that things may not be what they seem; a country may be in need of capital, its citizens may be imbued with prudence and thrift, and yet the *attempt* to save will not only be abortive but through its adverse effects upon income may lessen the amount actually saved and invested.[1]

If full employment is to be maintained, all savings that are made must be offset. Two extreme schools of thought have drawn opposite conclusions from this. On the one hand, the classical economists in their formulation of the celebrated *Say's Law of Markets* simply denied that there ever could arise a problem of offsetting savings. For them, what was not consumed was automatically invested. The exact elucidation of this doctrine is always obscure, and it takes on suspiciously many unrelated forms—from the innocuous assertion that goods exchange against goods and that all values are relative, to vague notions of conservation of purchasing power and absence of leakages. In other formulations, a lowered real wage is believed to be effective in expanding demand along a "general demand curve for labor" drawn up in analogy with the negative sloping partial equilibrium demand curve for a single commodity. Or still again, it used to be argued that the interest rate, if flexible, would somehow equilibrate the demand and supply of savings and investment, and at the same time in some manner equilibrate the supply and demand for labor. Finally, in its most sophisticated form, reference was made to the fact that a general equilibrium system with flexible prices had for its mathematical and economic solution the equating of supply and demand in all markets. In the last analysis, then, only *inflexibility* in prices or costs could give rise to unemployment.

[1] Much of this had been intuitively realized for a long time. But only in the last half-dozen years has an unambiguous analytical formulation been possible. And even today the same facts can be given a favorable interpretation by the judicious use of the word *investment* or, if the opposite case is to be made out, by the use of the word *saving*. More careful analysis shows that the intrinsic empirical phenomenon cannot be changed simply by revising our descriptive vocabulary.

This is not the place to attempt to deal adequately with so complex a doctrine. It can be said, however, that just as those economists who were free traders have developed the best arguments for protection, so it is those economists who use the Keynesian analysis who have been able for the first time to patch together a reasoned defense of the proposition that price flexibility may have salutary effects upon employment.[1] The process can only be briefly indicated.

Broadly speaking, downwardly flexible wages are supposed to cause prices to fall, thereby to produce redundant money supply and low interest rates, and hence stimulate investment. Other favorable effects are supposed to flow from the stimulus to consumption that the increased real value of money stocks will allegedly bring.

All in all this is not an impressive case, involving as it does the inadequacies of a cheap money policy, plus a dependence upon favorable expectations. Furthermore, closer investigation shows that its effects are transient since it depends not on *low* wages and prices, but on *ever-falling* ones. In view of the adverse psychological and real effects upon the marginal efficiency of capital and the propensity to invest which an ever-falling price and cost level would entail, it is by no means certain but that even moderate rates of deflation would be disequilibrating and self-aggravating rather than favorable to employment and income.

Therefore, I shall not discuss further the now extreme view that price-wage inflexibility is a necessary condition underlying the existence of unemployment, and that its removal is a sufficient or important remedial measure. At the same time the equally doctrinaire viewpoint that the existence of saving must necessarily cause unemployment in all circumstances can be treated only briefly. Whatever the excesses of some older underconsumption writers, it is today recognized that there is nothing in the structure of production itself (value added, depreciation payments, Major Douglas' *A* and *B* payments, etc.) which makes impossible the realization of full employment over any finite time period. Provided that sufficient new capital outlets exist, any amounts which

[1] *Cf.* Prof. Lange's forthcoming monograph on flexible prices; J. R. Hicks, *Value and Capital* (Oxford, 1939), Ch. 20; A. C. Pigou, *Employment and Equilibrium* (London, 1941); G. Haberler, *Prosperity and Depression* (3d ed., League of Nations, 1942), Ch. 13; Gardiner C. Means, *Structure of the American Economy*, Vol. II (National Resources Planning Board, Washington, D. C.), pp. 9–17.

people wish to save can be offset.[1] It may be bad theology, but it is sound economics that a *sufficiently lucky* community can cheat the devil of ineffective demand indefinitely. Thus, the significant contributions of these earlier writers must be found in their realization that unemployment would arise unless very special conditions were met, and perhaps in their belief in the unlikelihood that these conditions will prevail.[2]

OFFSETS TO SAVINGS

It is the upshot of our discussion that the prospects for unemployment and depression cannot be determined on a priori or deductive grounds. An analysis of income determination can help in isolating the strategic factors involved and in suggesting the appropriate questions to ask of our available empirical statistical data. Specifically, we must answer the question, what are the processes by which savings can be offset. Broadly speaking, these can be divided into at least the following categories: (1) private net capital formation, (2) private losses, (3) foreign investment, (4) governmental expenditure in excess of tax receipts, (5) governmental fiscal policy aimed at changing the primary distribution of imputed income into a secondary distribution of net income after taxes, which is conducive to greater consumption out of the same total income, (6) increased governmental expenditures matched by equivalent taxes, (7) an upward shift in the propensity to consume at each level of income.[3]

Let us examine briefly each of these in turn. The most widely recognized is the first, private net capital formation. Historically this has taken the form of new heavy capital goods, primarily of

[1] This holds even after the output of the newly created capital goods comes upon the market provided that sufficient further investment outlets are forthcoming. *Cf.* the doctrines of Foster and Catchings, *Money* (Boston, 1923).

[2] It may be appropriate to record the belief that the future historians of economic doctrines will dispense with the false distinction between underconsumption and underinvestment or undersavings, and that the underconsumptionist writers will attain to a level of respectability hitherto denied them, if only because their instincts led them to see obscurely the elements upon which the modern income analysis is based.

[3] This mode of classification is arbitrary, but useful. Several of these items could be consolidated, and the careful reader will note that some of the offsets to savings are ways of preventing savings from arising rather than neutralizers of performed savings. The sum of these components will not equal total savings.

durable types. It is to be noted that public utilities, railroads, and residential construction have throughout our history overshadowed manufacturing industry in importance as a source of investment outlets. Since we exclude replacement expenditures, it is clear that this offset depends upon discovery of new ways of doing things, new products, dynamic growth and expansion. In behavior it is sporadic, volatile, and capricious. Its effective determinants are almost completely independent of current statical factors (level of income, etc.).

It is tempting to construct a theory of income determination analogous to the "Marshallian cross" of supply and demand by which price in a single market is determined; *i.e.*, to erect schedules of both saving and investment, at whose intersection income is determined. However valid this may be formally, it is necessary to insist that investment in anything but the shortest run cannot be related to income in the way that savings can. Even in the shortest run it is not the statical level of income, but its time pattern of change taken in conjunction with the existing stock of capital equipment, which determines investment. In the present writer's opinion, this cannot be emphasized too much, particularly in view of recent statistical attempts to estimate what the level of investment would be at high levels of national income.[1] At worst, such attempts simply indicate what levels of investment are *necessary* if income is to be at a high level, since the past coexistence of high investment and high income may represent causation from the former to the latter rather than vice versa. At best, they might hope to give the cyclical pattern of investment peaks which can be touched for a moment at the top of a boom; but even this is extremely doubtful since there is no necessary repetition from cycle to cycle of the sectors which lead in investment outlay.

While it is customary to think of capital formation as taking the form of heavy durable capital goods, there is no necessity for this to

[1] Ezekiel, *op. cit.;* R. Bissell, in this volume and in *Fortune,* May and June, 1942. Both of these authors attempt, by dealing with split-up components, to avoid the gross statistical error of deriving two independent schedules from essentially the same data. I do not believe that they succeed in this attempt. In any case, the data which both use are consistent with the alternative hypothesis that the scatter of investment outlay is traced out by shifts in the investment schedule.

It may be noted that one of these studies comes out with a pessimistic quantitative estimate of the ability of private investment outlay to lead to full employment, while the other paints a rosier picture.

be the case. Outlay to the public by private business enterprise in excess of its consumption sales constitutes income and employment creating expenditure. It may be for the purpose of building up (via advertising expenditure) such intangible assets as good will; it may take the form of a price reduction which only after a considerable period of time will pay for itself. Most important, such expenditure provides an offset to saving even if no asset, tangible or intangible, is created for the business enterprise. *Business losses* arising from imprudent or unfortunate expenditure are dollar for dollar as employment-creating as other private investment and provide equally potent offsets to savings. Historically such losses have been extremely important as an offset to savings. Recent trends, however, suggest that a considerable sector of business enterprise, particularly large corporations, are learning to adapt themselves to an unfavorable environment so as to avoid losses. It is quite possible that many of these could make adjustments so as to stay out of the red even at levels of national income corresponding to 50 per cent of full employment. On the whole, this is not necessarily an undesirable trend, since imprudent and wasteful expenditures are not the most desirable ways to provide employment. Nevertheless, this trend must be taken account of in reckoning the prospects for the maintenance of full employment on the basis of private demand alone.

It is too early to speak with any assurance concerning the future of foreign lending. On the whole, it seems to be the consensus of informed opinion that the prospects are not good for any substantial revival of private flotations in the form that we have known them in the past. No doubt we shall forge new quasi-public instrumentalities for the purpose of aiding in international reconstruction. These are best included under a discussion of governmental offsets to savings. Aside from these it may well turn out to be the case that the new international responsibilities which are forced upon the United States by her leading position in world affairs will require a renunciation of beggar-my-neighbor attempts to export without importing, so that in the postwar world the foreign balance may be an unfavorable rather than a favorable offset to savings.[1]

During the last decade we have had to rely heavily upon the fourth offset to saving, *viz.*, deficits. A realistic appraisal of the future would suggest that these can only be wiped out by a sub-

[1] *Cf.* essays in this volume on "International Economic Relations."

stantial strengthening of our tax system. It seems extremely unlikely that postwar Federal expenditures can shrink to prewar levels. Nor is it certain that the retention of many parts of our wartime tax structure will yield enough revenue to balance the budget. There is the further paradox that the heavy yields of our tax structure may depend upon high levels of national income, which levels are premised upon large sustaining deficits. This inevitably raises the question as to the perils involved in a growing public debt.[1] If orthodox central banking operations are not adequate to prevent large increases in debt service charges and interest rates, careful thought should be given to the alternative of the controlled issuance of noninterest-bearing debt. It is becoming increasingly apparent that this would have little or no effect upon the magnitude of public expenditure and would differ in no significant degree from bond sales as a contributing factor to inflation. Whether or not we embark upon such a policy, it is highly desirable that the Treasury follow a militant policy of interest rate reduction except where subsidies are to be granted on the basis of broad social desirability.

Because the same fraction is not saved out of the *last* dollar of a man's income, the amount which will be saved out of a given volume of total income depends upon its distribution among individuals. This distribution is not to be regarded as a fundamental datum, but can be altered by means of tax collections which have a differential effect upon the different income classes, and by government expenditure which does not go to all classes in the same proportion. Progressive income taxes are one way of achieving this result, as are estate and capital taxation. In view of the administrative limits to steep income taxes,[2] the corporate tax may be useful in giving us a tax system with less sag in the middle. On the expenditure side an expanded welfare program involving public health, old-age pensions and assistance, unemployment compensation, family allowances, educational aids, as well as relief for the underprivileged, all contribute toward a distribution of income more favorable to consumption. As yet we do not fully realize how large a fraction of our welfare expenditures are *not* associated with depression and unemployment, but rather with the higher social standards which our democracy has adopted. Consequently, even continuing full

[1] See S. E. Harris, on *"Public Debt,"* in this volume.

[2] H. C. Simons in his *Personal Income Taxation* (Chicago, 1939) indicates how we may strengthen our progressive tax system.

employment will not cause a shrinkage of welfare expenditure to predepression levels.[1]

While substantial gains in consumption can be made by these distributional methods, it would be well not to expect too much of them. For the difference between the *marginal* propensity to consume of poor and wealthy is by no means so great as between their *average* propensities to consume. Consequently really large changes in the inequality of income distribution are necessary to reduce savings by even 10 per cent. And at the same time that savings are being reduced, there is some adverse effect upon the offset to saving provided by new investment. I cannot do justice to these aspects here. But it may be said that the modern corporation provides a mechanism for the pooling of risks so that the government does share in the risk takers' losses.[2] Undoubtedly democratic communities will continue to attach primary importance to the equity considerations in favor of a more equal distribution of income, letting the favorable effects upon consumption form a secondary argument for them.[3]

Only recently have I become convinced that item 6 does provide a genuine offset to saving—that a budget balanced at a high level, with "nonprogressive" taxes and expenditure, is nevertheless employment- and income-creating. A proof cannot be attempted here. However, if valid, this form may provide an important method by which our economy can hope to maintain the level of effective demand.

[1] The government by nonfiscal policies such as wage regulation, price regulation, trust busting, etc., can hope to offset the primary distribution of income in a more favorable direction.

[2] Furthermore, it is the curvature of the tax structure rather than the steepness of the tax gradient which introduces the unwillingness to invest because the government pockets winnings without sharing in losses. A careful study of the economic history of the United States and England would probably show that "venture capital" in the usual sense has not provided an important fraction of total offsets to savings. Its real importance lies in their productivity-increasing aspects rather than in their stimulating effects upon employment. Even here the reluctance to assume risk because of modern tax systems results in a delay between the discovery of new processes and their introduction rather than in their total loss. Instead of accumulating an ever greater pool of unused inventions, we become synchronized some few years behind our maximum potentialities.

[3] Space does not permit a discussion of the influence of wartime fiscal policy upon the distribution of wealth holdings at the end of the war and upon interest income in the postwar period.

The seventh process by which one generation develops new consumption wants and needs so as to offset the amount which would be saved under earlier patterns has been of the greatest historical importance in sustaining effective demand. In a sense, the others are only makeshifts. Private investment only puts off the evil day. It must be followed by more investment in all succeeding time. Increased consumption standards, on the other hand, are more or less irreversible. They provide in each period sustaining demand.

Nor is it to be thought that a high consumption economy means a low investment-savings economy. On the contrary, only where consumption demand is high are large savings and investment possible.[1] A high consumption economy may mean low investment in percentage terms; but it means higher absolute levels of investment.

As we have seen in earlier sections, the United States seems historically to have increased its consumption standards at about the same rate as its productive potentialities. Even if this should continue to be the case in the future, it is quite possible that the problem of offsetting savings would become more acute as we grow more wealthy. For with increasing real income, constant percentages saved means that we must find ever-increasing absolute volumes of offsets.

Besides, there is no mechanism, no natural law, which guarantees that these processes will develop in balance during the years ahead. In the past the country-to-city movement has resulted in higher propensities to consume, but now this process has decreased in importance. The war itself has meant a reversion to lower consumption standards and may leave us a generation behind where we would otherwise have been. Despite our backlog of deferred consumers' durable goods purchase, considerable time may be required to thaw out frozen consumption habits. Most important of all, since 1929 we have had a distinct break in trend. The great depression meant an intensification of the desire to save because of personal insecurity. Throughout this decade our income ceased to grow but our productive potential increased steadily. The con-

[1] For completeness it should be pointed out that under exceptional circumstances low consumption can lead to a fall in income and interest rates sufficient to stimulate investment more than unfavorable consumption sales discourage it. See O. Lange, "The Optimum Propensity to Consume," *Economica*, February, 1938.

sumer did not know what he was missing in the way of new good things of life and so was not able to develop new tastes at the same old rate. As in other branches of economic analysis, there is something of a vicious circle here. Provided we succeed in maintaining high levels of income, habits are developed which make it easier to continue to hold to these levels. If once a slump is permitted to develop, the situation may be stabilized at a low level.

BALANCE SHEET OF THE FUTURE

With the theory of income determination outlined in the previous section we are now in a position to evaluate the factors favorable and unfavorable to high levels of employment in the postwar years. Those who are optimistic concerning the prospects for a spontaneous postwar boom of some duration based upon private demand alone entertain this belief for one or more of the following three reasons:

1. They point to the impressive ease with which demobilization took place after the First World War.

2. Others attach importance to the fact that as a result of the current struggle we will necessarily use up our stock of producers' and consumers' capital equipment in excess of replacement. The unavailability of goods during the war, taken in conjunction with high monetary incomes, means that family savings will necessarily increase, taking the form of government bonds, savings accounts, and life insurance. Installment debt has already declined greatly, and by the end of the war the same will be true of mortgage indebtedness.

Once the war program has ceased to accelerate, the same process of increased liquidity will become true of business enterprise as well, particularly large business. Depreciation allowances in excess of gross investment will eventually go into cash, government bonds, and reduction of liabilities. These gross savings will be swelled by earnings on war contracts, rapid amortization of war equipment, and eventually by war end indemnity payments from the government to armament-producing firms. Already the tendency toward greater liquidity is getting under way, as yet unnoticed by observers who fear that the war will strip corporations of liquidity.

If we add to this the forced saving plans which the future will certainly bring, as well as postwar tax refunds to corporations, it will be seen that the *real backlog of deferred demand* as a result of wartime depletion of capital will be accompanied by the financial means to make it effective.

3. The third group of optimists are those who all along, regardless of the war, have thought that prosperity was just around the corner—or would be if sound governmental policies were adopted. This group looked forward throughout the great depression to the imminent appearance of a large block of deferred demand, which until the war had not yet developed. If the war were to end early, they would still expect prosperity even though no backlog of wartime deferred demand had as yet arisen. This is the most difficult view to substantiate or refute, resting as it does in part upon faith and in part upon the fulfillment of political conditions other than those we are likely to face for a considerable time in the future. Needless to say, the validity of this viewpoint is unaffected by the war. It is worth as much or as little as before 1939.

Because it rests upon historical facts, the first viewpoint may be discussed at greatest length. This is done in the next section. After a few words on point 2, some sources for pessimism will be indicated.

AFTERMATH OF NOV. 11, 1918

An examination of the popular and learned periodicals issued during the last war shows almost no preoccupation with problems of postwar planning. As victory finally loomed ahead, a number of programs for "Reconstruction" did emerge, but these were almost exclusively international. A few cautious souls warned that temporary problems of glut in the labor market might arise if soldiers were demobilized too rapidly, and that consequently the speed of discharges should be regulated with reference to unemployment. But on the whole, in the radical and in the conservative press, there was little concern over the problem of achieving or maintaining full employment.

As soon as the Armistice was signed, a feverish anxiety swept over the country to return to prewar "normalcy," to "get the boys out of the trenches by Christmas." Those soldiers who had not gotten overseas were discharged largely in December, while the A.E.F. was disbanded rapidly all through the first half of 1919. By one year after the Armistice, about 4 million soldiers, sailors, and marines had been disbanded, or all but a skeleton force.

On Nov. 12, the long-distance wires were kept busy canceling war contracts wherever possible. Within a year, 2 billion of these were settled, with cash payments by the Treasury averaging about

one-eighth of the face values of the contracts.[1] Price and production controls were also removed as soon as possible, many by the end of 1918. The administrators of the emergency agencies, largely recruited from private industry for the "duration," were eager to return to private business.

The picture is clearly that of a planless rush to wind up the war activities as quickly as possible, without thought of possible adverse consequences. And all this was done without appreciable dismissal pay for soldiers, in a system not yet possessing unemployment insurance, with primitive labor exchanges and placement services, and with little or no provision for direct or work relief.

The upshot of all this is well known. There was no market crash or crisis, no great increase in unemployment, no deep cumulative downward deflationary spiral. Instead, we witnessed the very mild recession of the winter of 1918–1919. This was followed in the spring of 1919 by an upturn in prices and activity rising to a crescendo in the first half of 1920. The 1919–1920 boomlet came to an end with the collapse of farm prices in the summer of 1920 and was succeeded by the very sharp, but fairly brief, recession of 1921.

These events are a matter of record. They are interpreted by many to mean that private industry at the end of the last war was able by itself to solve the problem of demobilization and postwar transition. Some will take a further step and ask whether similar tactics are not feasible when the Second World War comes to an end. Unfortunately, the argument fails at the first step.

Closer examination of the facts reveals that the picture painted above of the 1919–1920 boomlet is superficial and seriously distorted. *It was not a privately maintained boom. It did not rest upon backlogs of deferred demand. It did not bring with it the material prosperity usually associated with a boom. It was not based upon stable, enduring foundations. Many of its characteristic features are precisely those which can be expected not to be present at the end of the present war.*

The single most important fact to be emphasized is that, however anxious we were to end the war immediately after Nov. 11, 1918, this was nevertheless not possible. Economically speaking, the First World War did not end with the Armistice, but continued until well into 1920. In the first months after November 11, our war expenditures were larger than at any previous time. It was these unprecedentedly high "net income-creating expenditures" of the Federal government which eased the demobilization of that period.

[1] *Annual Report of the Secretary of War*, 1919, p. 43.

Nobody wished to spend this money; it was not part of a plan, but simply proceeded from the necessities of the moment. Projects almost completed could not simply be terminated in mid-air. After the Armistice we lent $2 billion to the Allies, and spent hundreds of millions of dollars to feed the continent of Europe. Because of this, our favorable balance of trade was greater in 1919 than at any time during the war or during the decade of the twenties. The shipping shortage operated more to reduce imports than exports, again contributing artificially to offsets to savings. While not all the favorable balance of trade was financed by the government, some substantial fraction being financed by extraordinary short-term capital lending, there is no indication that the latter phenomenon will be present when the Second World War comes to an end.

Not knowing the troublesome times ahead, the private business community greeted peace with optimism. As the spring of 1919 wore on, sales increased in retail lines such as clothing for returning soldiers, household goods, etc. With the removal of price controls, the wholesale price index began to rise, in the end soaring from the final war level of around 200, on a prewar base, to almost 250. This set off a wave of inventory accumulation, or attempted accumulation, which formed a substantial fraction of total offsets to savings; and the paper increase in inventory values was considerably greater.

From its nature this was an unhealthy base upon which to erect a boom. Price increases led to attempted inventory accumulation, further accentuating the price increases. But it was not enough for prices to stay at these abnormal levels; once they ceased to rise, or leveled off, the whole structure had to collapse. It is worth contrasting this 1919–1920 boomlet with the longer sustained prosperity plateau of the twenties. The latter was not at all based upon the stimulus provided by a temporary upward price and inventory spiral. In this respect 1919–1920 was more like the incipient boomlet of 1936–1937. In both cases an unstable price situation was aggravated by the rather drastic reductions in net Federal spending, giving rise in one case to the recession of 1938 and in the other to the 1921 recession.

In one important respect the picture of the 1919–1920 boomlet as simply a paper upswing must be qualified. From mid-1919 to the end of 1920 American industry spent unprecedentedly large sums upon gross plant and equipment.[1] The rate of expenditure exceeded

[1] Lowell J. Chawner, "Capital Expenditures for Manufacturing Plant and Equipment, 1919–1940," *Survey of Current Business*, March, 1941.

that of the late twenties or of any other period until the present war effort. In view of the definitely secondary importance of manufacturing as a source of investment outlets, and in view of the *unprecedentedly high rate of saving immediately after the First World War I*,[1] these outlays are not to be given too much importance as offsets to saving and as income maintainers in this period. Nor did they contribute much to the output of that period, which available indices of production show to have been lower than 1916 levels despite the alleged boom conditions.[2] But they were undoubtedly of importance as a tooling up for the mass-production levels of the golden twenties and for the later economies in the use of labor which increased productivity per man-hour made possible.

Despite this qualification it remains broadly true that the 1919–1920 boomlet is nothing to look back upon with pride. It was a boom without prosperity initiated by the inevitable large government expenditures necessary to wind up the war. It continued on the momentum of these expenditures plus transient speculative elements of inventory accumulation induced by booming farm and industrial prices. The bubble necessarily had to burst sometime, and the fact that the resulting depression was short-lived and was followed by a period of sustained prosperity must be explained in terms of a concatenation of fortunate circumstances, of which only a fraction can be related to private investment outlets or to the war itself.

Furthermore, careful study of the First World War leads to the conviction that it was utterly different from the present conflict and that analogies with it are more dangerous than otherwise. It was not total war as this one is. There was relatively little conversion of peacetime activity. Most important, our military production, aside from operations begun in response to Allied orders, literally never got under way on an appreciable scale.[3] No more illuminating contrast could be found than in a comparison of the roles of both the automobile and aircraft industries in this and the last war.

[1] S. Kuznets, *National Income and Its Composition*, 1919–1938, Table 1, p. 137, and Table 58, p. 322.

[2] S. Fabricant, *The Output of Manufacturing Industries*, 1899–1937 (New York, 1940).

[3] Apparently the year 1918 was planned to be a year in which we were to build up our military productive capacity for an all-out struggle in 1919, and thereafter. The speedy end to the war seems to have come as a surprise to expert and layman alike.

When this war comes to an end, more than one out of every two workers will depend directly or indirectly upon military orders. We shall have some 10 million service men to throw on the labor market. We shall have to face a difficult reconversion period during which current goods cannot be produced and layoffs may be great. Nor will the technical necessity for reconversion necessarily generate much investment outlay in the critical period under discussion, whatever its later potentialities. The final conclusion to be drawn from our experience at the end of the last war is inescapable—*were the war to end suddenly within the next 6 months, were we again planlessly to wind up our war effort in the greatest haste, to demobilize our armed forces, to liquidate price controls, to shift from astronomical deficits to even the large deficits of the thirties—then there would be ushered in the greatest period of unemployment and industrial dislocation which any economy has ever faced.*

This does not deny that there may be a boom after the war. In this the experts may still be correct. For the release of controls upon demand coupled with plentiful amounts of monetary demand might well give rise to price increase, inventory buying, feverish speculation and all the superficial earmarks of a boom. But it would be the antithesis of a prosperity period, constituting instead a nightmarish combination of the worst features of inflation and deflation. Nor, having spent itself, could it be expected to evolve into healthier channels. Instead, the final outcome would undoubtedly be a cumulative hyperdeflation from which, at best, we should lose a decade of progress and which, at worst, our democracy would not survive.

Of course, this is not intended as a picture of what will in fact happen. For there is every reason to believe that we shall not be lulled into a feeling of false security by the last war's experience or by the half-truth that the end of the war will witness a boom. No doubt, we shall retain direct controls for a period after the conflict ends. We shall taper off war production gradually. We shall undertake income maintenance in the form of dismissal pay for soldiers, unemployment compensation, direct and work relief expenditure. It is probable, although less certain, that, in addition, the Federal government will initiate employment maintenance measures such as large scale public works, etc. But even these will not necessarily be adequate to maintain full employment or any approach to it. In the next section, I shall discuss factors favorable to employment in the period after the immediate demobilization and

reconversion crisis. It may be said in advance that, however favorable these are, they can be completely nonoperative if we do not take very far-reaching measures to bridge the immediate transition period—measures much stronger than those envisaged in current discussions.

THE BACKLOG OF DEFERRED DEMAND

Undoubtedly this factor will be of the greatest importance in the postwar period. What is needed most of all is a series of detailed quantitative studies, sector by sector, of the extent to which the war is depleting consumers' and producers' stocks of capital equipment, in order that more precise estimates can be made. While such studies would confirm the importance of this source of demand, they would also, I believe, provide a healthy corrective to many currently held inflated expectations.

Until the summer of 1942, no deferred demand on balance had accumulated. On the contrary, inventories of producers' and consumers' durable and nondurable goods were at an all-time high. In the two years following 1939 we had added almost one-half as much manufacturing plant and equipment as we had been able to accumulate in all our previous history. Much of this will be convertible after the war, resulting in some fields in tremendous reverse backlogs —surpluses and not deficiencies. No conceivable increase in peacetime demand could possibly absorb the capacities for aircraft production and machine-tool production which the war will leave us. The same is true of many of the metal trades.

Furthermore, implicit in the usual reckoning of deferred demand is the assumption that there is a fixed total over time which must necessarily be spent. Given the technological change which the war will inevitably bring, this is by no means necessarily the case. We must take care also to avoid double counting. If a man goes without an automobile for 6 years, he does not then have a demand for six automobiles, nor will he necessarily spend in all subsequent time upon automobiles an extra amount equal to the 6 years' expenditure forgone. This means that the backlog will increase with the length of the war, but not in direct proportion. For nondurable goods there need be no backlog at all. Consumption forgone today is gone forever.

Upon even the most optimistic reckoning the magnitude of the backlog is necessarily finite. If bunched into a short enough period, one can produce as large a boom as is desired, but it will not last. If

spread over a long enough period of time, its contribution to the rate of employment may be quite small. A last point to be mentioned is the fact that deferred demand is a fair-weather friend. What has been postponed can be postponed longer. Even if individuals and corporations have adequate funds to finance expenditure, they are unlikely to do so if the bottom is falling out of the market for goods, and if unemployment is mounting.

All this suggests that deferred demand represents a favorable reinforcing factor, but not one which in and of itself can be relied upon to initiate and sustain a lasting prosperity. There is no justification to envisage a "generation" or decade of prosperity from this factor. On a fairly liberal estimate of the amount of war bonds which individuals will accumulate, the stock of unused automobile miles at the end of the war, the level and potentialities of installment selling, etc., it is certain that under no circumstances could automobile production after the war require the employment for as long as 2 years of the 1½ million laborers who will be in the automobile and aircraft industries. In fact, without striving to be pessimistic, it is possible to derive the estimate that the total backlog of deferred demand could be made good by our productive capacity at the end of the war in a period from 18 months to 2 years, and this on the favorable assumption that we successfully meet the immediate demobilization crisis. Compared with a deficit of $40 billion per year, this is not of primary importance.[1]

CONCLUSION

All our findings lead to the conclusion that there is serious danger of underestimating the magnitude of the problem of maintaining continuing full employment in the postwar period. Those who complacently predict a boom are likely to find their expectations fulfilled, but not with respect to the employment and real-income aspects usually associated with a prosperity period.

Even if correct, the realistic appraisal presented here does not provide grounds for pessimism. We can, and I am confident that we will, pursue policy measures appropriate to the challenging situation. The penalties for failing to do so will be serious, but the rewards for courageous action will be commensurately great.

[1] The reader should compare this view of future private demand (as well as those given by the other contributors in Part I) with the more optimistic estimates by Dr. Bissell.—EDITOR

Chapter III

TOTAL WAR: A DESCRIPTION IN TERMS OF EMPLOYMENT[1]

Dal Hitchcock

I

For 3 years we have seen the impact of total war spread until it is felt in every phase of economic life. We now understand the effort that will be required for victory. Were this a partial war against a foe of lesser strength, the task of foreseeing the continuing development of the economic pattern of war would be more difficult, but as matters clearly stand victory will take all our might. We know that civilian, or nonwar, production must be cut to the bone unless we are willing to gamble on a windfall victory.

For some months past, basic war-production planning has been done in terms of the over-all limits of resources, factories, and man power rather than in terms of the estimated numbers of planes, tanks, ships, and guns needed to outshoot the Axis. We can outshoot and outbomb Hitler and Hirohito, but to do so will take everything we can put into the war effort. Consequently, we know now that as the war continues civilian production and services will be cut to an irreducible minimum while raw materials, power, essential services, and man power are diverted to the war effort. This gives us one major factor determining the basic pattern of the economic dislocation already and yet to be produced by total war.

Planning is for not only an all-out war but a long war. Military and economic strategists are not thinking of a 100-yard dash to victory that would leave us exhausted at the end of the spurt. Were we certain that a supereffort could destroy the Axis before the autumn of 1944, the national belt could be tightened, the civilian economy could live largely on its fat, and the military production program could be focused and specialized. There would be no need

[1] Except when otherwise noted, the computations and estimates shown herein are based on published employment statistics of the U. S. Bureau of Labor Statistics, Washington, D. C. Estimates of war's-end and postwar levels of employment are the individual responsibility of the author.

to worry about tires for civilian passenger cars in 1945. The keel for no battleship would be laid unless it could be completed before the expected end of the war. We could freeze present designs for cargo planes, bombers, and fighters without concern that they would become obsolete. War production could be stepped up and the armed forces expanded far beyond present plans.

The United Nations are not planning to win the war within 2 years because were such a campaign to fail we most certainly should lose to the Axis within 3 or 4 years. We should be in the position of a spent runner called upon to continue a race. In the war ahead we must maintain a carefully integrated and balanced economy whose war effort, when raised to its peak, can be held there for 2, 4, or 6 years. Through these economic tactics we force the Axis to fight a sustained war in which superior industrial strength spells victory. The end of the war may come sooner than the strategists dare to think, but the plan for victory has been laid in terms of economic adjustments to war that can be sustained indefinitely. This is a second major factor in the economics of total war.

It is this plan for all-out war and for a sustained war effort which will determine the industrial and general economic dislocation to be produced if the war continues through 1944. In event of an earlier peace the distortion will be less severe, but it is toward this ultimate pattern of operations that we rapidly are moving.

II

In the shift to an all-out war effort, one of the most pronounced and significant changes being achieved is in agriculture. The nation's war effort will not have reached its peak until the armed forces, manufacturing industries, and essential services have drawn away some 2,500,000 of agriculture's average 1940 labor force of 10,500,000 workers. While this is happening, agricultural production is being expanded. Marginal lands that produce nothing more than scanty subsistence for the families living on them produce nothing for "export" to the rest of the community or to our allies. Other lands can feed these families after they have been transferred to productive work in the war effort. Characteristically, 50 per cent of America's farms produce 85 per cent of her marketable agricultural output, while the remaining 50 per cent of the farms yield only 15 per cent of the crop. Already it has been demonstrated that by concentrating labor on the best lands total production can be increased sharply with reduced man power.

This wartime curtailment of the use of marginal lands and the reduction of the disguised unemployment of the families who have worked them for subsistence only, sets the stage for a fundamental postwar attack on the farmer's problem.

With sustained national full employment after the war, there will be no economic force driving unemployed workers and their families back to subsistence farms or to low farm wages, whether paid in cash or kind. In fact, agriculture will compete with industry for its labor supply rather than being saddled with millions of desperate families pushed out of the towns and cities by depression and seeking escape from starvation "back on the land." With the agricultural labor supply no longer abnormally swollen by nonagricultural unemployment, farm prices and farm incomes will be relieved of the pressures that have held them below industrial incomes and prices. Total war, when we reach an all-out effort, will have cut from the farmer's neck the depression millstone of an excess labor supply. If at war's end we are prepared, as we must be, to sustain national full employment, this constructive by-product of the war can become a permanent gain.

III

Whereas the ill wind of war has blown good to the farmer, it blows danger for almost every other worker and businessman. We think of the war effort in terms of industry, the plants producing planes, tanks, ships, and guns. The government has turned, perforce, to the nation's great manufacturing industries for the production of the specialized goods of war. Manufacturing corporations have been converted and distorted until war and prewar resemblance has become a matter of name only. The economic necessities of total war, however, call for alterations of the nonmanufacturing sectors of the economy that will be equally far-reaching.

Had 1942 been a year of peacetime full employment, with some 56,000,000[1] persons in the active labor force, an average of 2,000,000 would have been unemployed in transit between jobs. Agriculture would have engaged an average of 10,000,000, and all nonagricultural pursuits 44,000,000. This nonagricultural employment would have included 5,500,000 proprietors and self-employed persons, including domestic servants, and 38,500,000 employed workers. Aside from the manufacturing industries, which would have

[1] Bureau of the Census, *Estimates of Labor Force, Employment, and Unemployment in the United States* (Washington, D. C.).

employed about 13,500,000, governments (Federal, state and local) with 4,500,000, transportation and public utilities with 3,500,000, and mining with 900,000, there would have been 16,000,000 people engaged in construction, services, and trade. During 1942 attention was focused on the economic dislocation produced by the conversion of existing manufacturing industry; in 1943 and 1944 we shall watch the war effort expand manufacturing employment toward 18,000,000 or 19,000,000 and reduce man power in services, trade, and construction to a level of 7,000,000 to 9,000,000. We have accustomed ourselves to doing without new automobiles, refrigerators, electric fans, and nearly all metal products. Now we shall learn to get along with practically no new nonmilitary construction, fewer stores, fewer beauty parlors, fewer real estate and insurance offices, and less delivery service. The men and women of these trades and industries are needed elsewhere in total war.

The changes being produced by war in agriculture should leave a residue of good after the conflict. The conversion of heavy manufacturing industries will leave a postwar problem of physical readjustment but their business organizations generally will be left intact. In the fields of construction, wholesale and retail trade, and in the areas of personal, financial, and other services, a more critical postwar problem is being posed. It is in these sectors of the economy (and in nondurable manufacturing which has been similarly affected) that the bulk of the country's small and medium-sized independent enterprises are to be found.

As the transfer of workers from nonessential to essential war employment takes place, the business organizations which were their employers in 1942 are passing out of existence. No provision has yet been made for bringing business firms back to life after the war. Consequently, in these fields we look ahead to the concentration of trade, services, and construction into the hands of the larger and financially stronger firms which will be able to survive for the duration in a state of semi-suspended animation. Unless this situation is corrected, the war will result in the extensive elimination of small and medium-sized independent enterprises in those sectors of the economy where up to now they have tended to persist with greatest vigor. Such an institutional change would seem to be highly undesirable if one of the nation's cardinal war objectives is the preservation of a dynamic system of free business enterprise. In the early months following the war, it will be important to expand employment in construction, services, and trade from a level of less

than 9 million toward 16 million with all possible dispatch. To a degree, the rate of peacetime expansion will be controlled by the reconversion of consumers' durable goods and construction supply industries, but certainly as important as the physical reconversion of manufacturing plants will be the financial factors controlling the rebirth of business organizations. The task of reemploying millions of workers is one of organization. Business organizations cannot take hold unless they have financial resources with which to work. The war is dissipating those resources. Reemployment will be neither rapid nor within the framework of independent enterprise unless postwar financial factors are remobilized for peace coincidentally with the remobilization of the physical factors of production.

IV

New housing construction will be at a virtual standstill at war's end. Expansion of the construction industry will depend upon the general postwar economic setting, but the history of the industry over the past 20 years indicates what may be expected of it under even relatively favorable conditions.

Between 1921 and 1922, new housing construction expanded by 61 per cent. From 1922 to 1923, a further expansion of 32 per cent occurred. From the depths of the depression in 1933 to the first recovery year of 1934, new housing construction increased 43 per cent, and 1935 saw a further expansion of 54 per cent from the 1934 level.[1] Reasoning from the industry's records of the past and considering the deficiency in housing construction which will have accumulated, both during the depression and the war, it does not seem improbable that employment in new housing construction could expand to 800,000 persons within a few months.

Rapid expansion will not take place, however, without a carefully formulated reconversion program for the construction supply industries. Construction materials must flow from manufacturers before work can start at building sites. At war's end most of the plants of the construction supply industries will face the problems of reconversion before they can produce and ship building materials. Machine tools and other equipment will be needed. Working inventories of raw materials will have to be accumulated and in many plants personnel will have to be reorganized. If all this is to be accomplished with the speed needed to be effective in offsetting a

[1] Comparisons based on data covering nonfarm areas of the United States, U. S. Department of Commerce (Washington, D. C.).

rapid decline of employment in war industries, advance programming will be essential. During the early months of transition from war to peace, the functions of the Bureau of Priorities of the War Production Board and the Office of Price Administration will change in character but not in importance. Their work must continue until the economic stresses of war have been eased. As we have been ruthless in distorting the pattern of manufacturing operations to meet the needs of total war, we shall have to be realistic in re-forming that pattern if we are to achieve a transition to peace with a minimum of dislocation and delay.

It will be important to make a general appraisal of industries in terms of the speed with which they can be shifted from war to peace, their relative importance in terms of employment, the nation's relative needs for their products, and their importance as areas of opportunity for independent private enterprise. New housing construction stands out as being important when judged by each of these criteria. The country needs new housing on a large scale. Activity can be expanded in terms of local need and available labor supply. Nationally, the industry will have an ample supply of skilled labor. Reexpansion will foster the rebirth of small and medium-sized independent business units.

In many lines of service and trade, postwar reexpansion will be less dependent on the redevelopment of industries of supply than is the case in construction, the speed of their expansion depending almost wholly upon levels of effective demand and the availability of capital and credit for small and medium-sized business ventures. It is not unlikely that employment in all branches of service and trade can expand from the war's-end level of approximately 7,500,000 (6,500,000 to 8,500,000) to 12,000,000 within 1 year, and on toward 13,000,000 or 14,000,000 within 2 years. The branches of service and trade likely to lag are those dependent upon the production and sale of automobiles and other consumers' durable goods, which again are the industries revolutionized by war and which will have to go through a reverse revolution of production processes during the early months of the postwar period. Here also the importance of a programmed transition of manufacturing activity suggests itself. While less flexible than housing construction, the manufacture, distribution, and servicing of consumers' durable goods at full employment will absorb greater numbers of workers from war industries and the armed forces. As in the case of construction, general expansion of employment in trade and services related to con-

sumers' durable goods will depend upon the rate at which the manufacture of the goods to be distributed can be regenerated. Along with the construction supply industries, consumers' durable goods manufacturing industries should have high postwar priority for materials.

V

Turning last to the manufacturing, transportation, communication, and extractive industries, it is possible to subdivide the area into five sectors, each characterized by particular problems of readjustment.

First, there are the industries of basic supply and industrial service. These include the extraction and primary processing of raw materials, transportation, and communication. In general, the war has not changed their basic technology nor their geographic distribution. They have been enlarged as a result of the specialized demands of war and will have to be brought again into normal relationship to the rest of the economy. In total, their postwar employment after a period of readjustment can be expected to approximate 5 million persons, and their war's end employment level is not likely to exceed 6 million. As employment in this group of industries declines by almost 1 million workers, it is to be expected that activity will tend to concentrate in the more efficient units, some of which are being built to serve the needs of war. In this group, disturbance to corporate entities will be pronounced but by no means cataclysmic, as promises to be the case in the trades and services.

In the second group of manufacturing industries are those whose production processes have been fundamentally altered by their conversion to the war effort. In general these are durable goods industries. They have been so completely revolutionized and so thoroughly admixed with new war plants that it is statistically impossible to compare their wartime employment with that of the prewar period or with probable postwar levels. However, before the war they engaged roughly 3,000,000 of the nation's manufacturing wage earners. The backlog of demand which will have accumulated during the war period may give rise to boom tendencies in these industries immediately after the war, because the rise of demand may exceed the new supplies made available. If these dangers are successfully averted, it can be expected that within a period of from 15 to 18 months following the general curtailment of

war-production contracts, employment in this group of industries will be stabilized at levels somewhat exceeding those of the relatively prosperous early months of 1940. A potentially important and as yet unappraised factor may, however, strongly influence the postwar development of the consumers' durable goods industries. In reconverting from war to civilian production an unprecedented opportunity for technological improvement will present itself. Production will be reorganized after an extended and complete shutdown. The adoption of new methods and of changes in product design may occur on a broad front. If so, reemployment probably will take place more slowly than would otherwise be expected.

Industries from the nondurable goods sector of the economy make up the third group. During the war they have been and will be influenced by a shortage of raw materials, transportation facilities, electric energy, and man power. The years 1941 and 1942 were a period in which industries needed directly in the war effort, *i.e.*, the durable goods industries, were curtailed and converted to war production. Late 1942 and 1943 is a period in which nonessential industries are being curtailed or completely shut down for the duration, not primarily because their plants are needed or can be used for war production, but because resources must be diverted from them to the expanding war effort. Since the plants and equipment of these industries cannot be converted to war, their postwar rejuvenation will be essentially different and somewhat simpler than that of the durable goods industries. If raw materials are made available rapidly after the cessation of hostilities, these industries should find it possible to return to full-scale peacetime rates of production with greater speed than the converted durable goods industries. In the first 6 months of 1940, wage-earner employment in the nondurable goods industries averaged 4,400,000. If the war continues beyond 1943, employment in nondurable *civilian* production will have to be reduced to a level approximating 2,100,000 wage earners. The reverse movement in nondurable industries as a whole after the war should be toward a level not far below 5,000,000 wage earners in the presence of full employment.

The fourth and fifth groups of industries include the specialized war plants and the new industries of continuing economic significance which have been brought into being or whose development has been rapidly accelerated by the war. In the fourth group are the explosives and ordnance plants, and in the fifth are such industries as synthetic rubber, synthetic fibers, military aircraft, and

substitutes for critical materials. Wartime employment figures for these industries are a military secret and hence cannot be discussed, but the problems of the specialized war plants will range from complete shutdown and demolition to full conversion for peacetime production. Since many of these plants, particularly those producing or handling explosives, have been located outside of the industrial areas in the country, the "mushroom communities" surrounding them will constitute a unique postwar problem. It is to be hoped that the nation's adjustment program will deal with such communities more effectively than was the case after the last war.

The sixth group of industries are those which will be directly affected by the resumption of peacetime international commerce. The war has completely altered the composition and directions of flow of world trade, and, if the objectives set forth in the Atlantic Charter are to be realized, the postwar pattern of international commerce will be markedly different than that of the 1930's or the 1920's. At the present, statistical summaries describing the over-all size and characteristics of these industries are not available, primarily for the reason that as yet the future of international commerce is not being dealt with in terms that identify the industries which will be affected. In the immediate period of postwar adjustment and even prior to the cessation of hostilities, the major developments of international commerce are likely to be related primarily to programs for the relief and rehabilitation of reoccupied areas. After the war it is likely that the export of capital equipment needed in the development of the resources of other nations will be of importance in the foreign trade of the United States.

VI

The picture of dislocation and probable direction of postwar readjustment that has been presented in the foregoing pages deals primarily with altered and changing relationships between the functional sectors usually designated when a breakdown of the economy is needed for analytical purposes. War, however, has introduced a new function of major significance—the armed services. Publicly discussed military plans call for an armed force to be maintained at a level of at least 10,000,000. These men and women, amounting to nearly 20 per cent of the nation's labor force, will be scattered throughout the world at the war's end, but their distribution cannot be foreseen. We do know, however, that in the

presence of an over-all shortage of war man power large numbers in the armed forces will not be retained idly within continental United States. Hence, war's end probably will find not more than 2,500,000 men stationed within the country.

The ending of hostilities will not release all men and women in the armed forces for immediate reintegration in the national economy. For some time the military forces of necessity will be engaged in administrative activities throughout the world, while civilian administrations are being reestablished in reoccupied nations and perhaps within the Axis itself. This will be the first task of what may later become an international police force, to which the United States would be a large and continuing contributor of personnel. Qualified observers feel that our postwar military force, including personnel contributed to an international police force, will be maintained at a level of approximately 2,500,000 men and women for a period of several years. The task of economically reintegrating members of the armed forces will involve the absorption of more than 7,000,000 persons (from the 2,500,000 who probably will be within continental United States and the 7,500,000 scattered throughout the world).

The occupational experience of members of the armed forces in the Second World War is sharply different than that of previous wars. Men and women returning to civilian life will have been using skills many of which after little or no retraining can find direct application in peacetime occupations. Notable examples of such skills are those acquired by ground crews in the air forces and by men who will have been in the large-scale construction projects attendant to modern warfare. Skilled workers demobilized from the armed forces should enhance the labor supply needed in the early months of the postwar period to facilitate the expansion of the construction industry, but surpluses of the skills needed in manufacturing industries will be a by-product of military experience. Postwar retraining and vocational education programs should be directed toward the fitting of workers for occupations in services and trade, for it is in these sectors of the economy that the largest relative expansions (as contrasted with prewar distribution of employment) must take place.

VII

In addition to altering the skills of the nation's labor force, other by-products of the war have significant implications for post-

war readjustment. The geographical distribution of the labor force is being profoundly altered. Not only are "mushroom communities" growing up around isolated war plants; workers by the tens of thousands are being drawn to centers of the heavy fabricating industries. The employed labor force of the Detroit industrial area, for example, probably will experience a wartime expansion of 250,000[1] workers, carrying industrial employment to 150 per cent of its prewar level. The New York metropolitan area, with its concentration of nondurable-goods industries, is experiencing a sharp loss of workers. Other areas, such as the center of aircraft production in San Diego, Calif., have doubled and then doubled again the manufacturing labor force engaged in war industries whose products now have no foreseeable postwar demand. A readjustment of these areas will be marked in part by the movement of industries to new labor markets and in part by the redistribution of excessive local labor supplies to localities offering employment opportunities. The magnitudes of these readjustments will be such as to demand that they be programmed rather than left to the unguided processes which were relied upon at the end of the First World War.

Still another by-product of the war effort will be a net addition to the labor force of women who will have entered it during the war and only a portion of whom will wish to withdraw at war's end. If the war continues until our full effort has been attained, the women added to the labor force will reach at least 5 million. Parallel experience in the First World War (with some marked differences in attitudes and surrounding conditions) indicate that 3 million may wish to retain their working status. Offsetting these factors will be the continued maintenance of a relatively large armed force and the loss of man power due to wartime casualties.

VIII

A summary of the dislocations produced by the war cannot be concluded without mention of closely related changes in the size and distribution of the labor force implied in the achievement of postwar full employment. These implications range from those for which quantitative definition is impossible to those that are susceptible of reasonably accurate statistical treatment. Sustained full employment will mean stabilized income for the family unit. As confidence in the nation's economic program grows, it is not

[1] U. S. Employment Service, *Labor Market Surveys* (Washington, D. C.).

improbable that "second workers" in many families will voluntarily withdraw from the labor force. If we are to make the freedom from want and the freedom from fear realities, one of the essential instruments will be an adequate program of security for the aged. It has been estimated that adequate and universal security payments to all persons aged sixty-five and over would result in the voluntary withdrawal of approximately 1 million persons from the postwar labor force. The broadening of educational opportunity, both in our public schools and at the college level, is a practically achievable immediate postwar objective. Truly universal educational opportunity in the United States would result in an increase of our school-attending population of 3 million people, aged fourteen to twenty-one years (some of whom would be serving in the postwar armed forces), with a corresponding reduction of the labor force. On the other hand, both the broadening of educational opportunity and the strengthening of the nation's health services will result in significant increases in employment opportunities.

Preliminary to the development of a program of transition from war to peace are the marshaling of the facts and the determination of the probabilities which describe the magnitudes and directions of readjustment. It is a dangerous error to think of war and postwar economic processes as being separate and distinct. Whether this war is thought of as a phase of the revolutionary process leading toward the dawn of the "century of the common man," or thought of as a gigantic and specialized economic effort—a cataclysmic interlude—the essential continuum of events includes both the transition from peace to war and the transition from war to peace. The distortions indicated by the foregoing statistical approximations define the problems which will come to the fore immediately upon the cessation of hostilities. The war program will not be ended—successfully—until it has carried the United States through to a full restoration of her democratic processes with stabilized full employment.

Chapter IV

SECULAR STAGNATION?

Alan Sweezy

I

The theory of secular stagnation is rooted historically in business-cycle analysis. Both are concerned fundamentally with the problem of business depression and unemployment. But, whereas business-cycle theory treats depression as a temporary, though recurring, phenomenon, the theory of secular stagnation brings out the possibility that depression may become the normal condition of the economy. Since business-cycle theory assumes that the general level of employment and output is satisfactory, it is interested primarily in compensatory policies, *i.e.*, in policies designed to offset temporary departures from the norm. Stagnation theory, on the other hand, is far more concerned about the general level of activity itself. The problem of reducing fluctuations is obviously of secondary importance if throughout all of the variations in production and employment a substantial part of the community's resources remain unused.

To understand why the secular stagnation theorists are apprehensive about the long-run trend of economic activity we must first review briefly the factors that determine the level of income, output, and employment in our economy.

Full employment of labor and other productive resources[1] depends, in a capitalist economy, on the maintenance of an adequate flow of investment expenditure. What is adequate depends, in turn, on the way the community divides its income between saving and spending on consumption goods. To support a particular level of income, investment must always be sufficient to balance the saving the community chooses to do at that level of income.

[1] There is, of course, no precise standard of what constitutes full employment. The term as used here means a degree of utilization of available resources roughly comparable to that which prevailed in past periods of prosperity such as 1923–1929, 1897–1907, etc.

If investment falls below this amount, income necessarily declines to the point where saving is sufficiently reduced to fit the smaller volume of investment spending.

If, for example, a $100 billion national income was necessary to provide full employment and if the community saved one-fifth of its income when it reached that level, then $20 billion a year investment spending would be necessary to support income at the full employment level. If investment were less, income would fall, production would be curtailed, and labor and other resources would be thrown out of employment.

The decline in income might be accompanied by a fall in prices as well as in output and employment. But the fall in prices would not necessarily mitigate the decline in employment and output (real income). We assumed that the whole process of contraction started with a reduction in investment expenditure, which reflected, of course, a lower demand for real capital goods. If the prices of capital goods fell as income declined, investment expenditure would be still further reduced. A new equilibrium could be reached only through the reduction of real saving to equality with the reduced demand for real capital goods. But real saving is a function primarily of real income.[1] Thus adjustment to a reduced rate of construction of real capital goods requires a reduction in real income, which is the same thing, of course, as a reduction in output and employment. Falling prices would help stop the process of contraction only if they reduced interest rates by making money relatively more abundant, or if the general decline was accompanied by shifts in relative prices of a sort either to stimulate a larger volume of real investment or increase the community's real propensity to consume.[2]

[1] If prices fall in a way that constantly tends to restore real income to its former level, saving, in real terms, will also tend constantly to rise. This means that investment tends continually to fall short of the amount the community tries to save out of its income (which is continually falling in money terms but also continually tending to regain its former level in real terms). If nothing else happened to stop it, the decline in income and prices might go on indefinitely.

[2] The kind of shift that would be likely to stimulate investment would, unfortunately, be likely at the same time to reduce the propensity to consume, and vice versa.

Experience of the last decade suggests that interest rates are likely to stop falling long before they reach zero no matter how great the relative or absolute increase in the quantity of money, *i.e.*, that at certain positive rates of interest liquidity preference becomes absolute.

An inadequate flow of investment expenditure thus means depression, unemployment, wasted productive capacity, poverty, and insecurity. If the deficiency in investment should persist over a long period of time, the economy would be secularly depressed or "stagnant."

A "stagnant" economy in this sense is by no means a static or unprogressive economy. Stagnation does not imply a cessation of technical progress, entrepreneurial initiative, or private investment. Writers of the "stagnation school" have frequently said that they expect to see a continued rapid rate of technological innovation accompanied by a continued volume of private investment which in absolute terms may be large. What they are concerned about is that it will not be large *enough*. Private investment might be running at the rate of $8 or $10 billion a year—a sizable amount in terms of the power plants, airfields, chemical factories, television broadcasting equipment, etc., it would build—and yet if the community's propensity to consume was such that $16 or $20 billion a year was necessary to maintain full employment, the economy would be depressed, productive resources would remain idle, and frustration and insecurity would poison the community's social and political life.

The thirties provide a striking example of "stagnation" combined with highly dynamic economic and social development. Even in the best year of the decade the American economy failed by a wide margin to achieve full employment of available resources.[1] And yet technological progress continued at a rapid rate, productivity rose markedly,[2] and in the second half of the decade gross private investment averaged nearly $10 billion a year.[3] The trouble again was not that there was *no* investment, but that investment was not enough to keep income at a level that would fully use the country's tremendous productive resources.

The theory of secular stagnation differs from the classical theory of the stationary state in its treatment of the propensity to consume and the rate of interest. The classical economists thought that with the continued accumulation of capital the rate of profit would tend to fall. This tendency might be offset for a considerable

[1] That some other national economies reached full employment earlier is attributable largely to the direct or indirect effects of preparation for war.

[2] *Cf.* Spurgeon Bell, *Productivity, Wages, and National Income* (Washington, 1940), pp. 270–280.

[3] "Savings and Investment," Hearings before the Temporary National Economic Committee, Part 9, p. 4122.

period by increase of population, opening of new land, and technological improvements. But the limits of population growth would eventually be reached and then the fall would be rapid. If capitalists kept on accumulating profit would disappear. But long before that point had been reached, they would probably become dissatisfied with the low return and would stop saving.[1] The result, however, would merely be a shift of expenditure from means of subsistence and other capital goods to articles of the capitalists' own consumption. Total demand and total employment of resources would remain the same. The stationary state would still be a full employment economy.

The modern theory of secular stagnation also assumes that capitalists will stop trying to invest their money long before the rate of return has fallen to zero. But it does not agree that they will, as a result, increase their consumption by a corresponding amount. The individual capitalist can both refuse to invest his capital at a rate of return which he considers unsatisfactory and refuse to shift from saving to consumption. He can go on accumulating without acquiring real capital goods. This is possible, of course, because of the availability of money as an alternative form of (individual) wealth.

But although the individual can accumulate wealth without investing in real capital goods, society as a whole cannot. The attempt on the part of separate individuals to save more than is being spent on capital goods necessarily forces income down to the point where they are collectively enough poorer to be content with the amount of saving that can be absorbed in real investment. Thus a fall in the rate of interest below the resistance point produces, not a quiet transition to the stationary state, but depression, unemployment, and social instability.

In the discussion of the secular stagnation theory there has been relatively little criticism of its assumptions with respect to interest rates and the propensity to consume. There seems to be widespread agreement both that investors will prefer money to other assets when interest rates reach certain low levels and that the psychological and institutional factors governing the propensity to consume, particularly the motives of accumulation and thrift and the

[1] "For no capital can then yield any profit whatever and no additional labor can be demanded. . . . Long indeed before this period, the very low rate of profits will have arrested all accumulation. . . . "—Ricardo, *Principles* (Gonner ed., London, 1929), p. 99. See also Ch. XXI, pp. 272–285.

distribution of income, are extraordinarily resistant to change. Critics have, on the contrary, been much more interested in proving that there is no need for a change in these factors than in trying to show that they are likely to change of their own accord. Debate about the stagnation theory thus has centered on the problem of investment demand.

The stagnation theorists believe that there is a persistent tendency in the modern world for private investment to fall short of the amount necessary to maintain tolerably full employment. Their critics, on the other hand, maintain that the opportunities for profitable investment are, and for a long time to come will be, quite adequate to support a high level of income and productive activity.

II

The stagnation school bases its prediction of a long-run deficiency on an analysis of the dynamic determinants of investment. It points out, to begin with, that a positive rate of net investment cannot simply be assumed as a "natural," permanent feature of any economic system. There is nothing in the mere process of production and consumption to require net investment. Production and consumption on the present, or any other already attained scale, can go on indefinitely without requiring anything but replacement of existing capital, which can, of course, be financed out of depreciation allowances.

Long-run net investment is a product of change and growth in the economic system. In the nineteenth century investment was stimulated both by revolutionary technological changes, many of which involved huge capital outlays,[1] and by rapid growth of population and territory. Since the turn of the century, however, fundamental changes have been in process. The field for territorial expansion has been narrowing, and population growth has been slowing down. Meanwhile, new sources of capital accumulation have been appearing as new areas have reached the stage of indus-

[1] There is a wide range of variation in the amount of capital required to introduce new techniques, new products, new resources, etc. Some, like the railroad or electric power, require a large initial investment per dollar's worth of final product, others, like radio or synthetic yarn, a relatively small investment. Still others, perhaps equally notable achievements from a scientific or technical point of view, can be introduced merely through the expenditure of current replacement allowances.

trial maturity. The result has been growing pressure on the available investment outlets.[1]

This pressure would probably have produced worldwide depression even sooner than it did, had it not been for the effects of the First World War. The war not only created an extraordinary replacement demand for capital but also weakened the economies of western Europe sufficiently to remove them for a time from the competitive search for new outlets. This temporarily left the field largely to American capital. Postwar reconstruction, both here and abroad, and the opportunity to exploit new foreign outlets aided materially in keeping income in this country at a high level in the twenties.

The basic changes that have been going on since the beginning of the century are important not only in explaining the unprecedented severity and persistence of the depression of the thirties[2] but also in appraising the outlook for the future. The reduced rate of growth, with respect both to population and to territory, is likely to be permanent. Technological change is still going on at a rapid rate, and, so far as anyone can see, it is likely to continue for a long time to come. In the thirties the changes were predominantly of the sort that requires relatively small investment of new capital. This, of course, may change. There may be innovations in the future comparable in their effect on investment to the railroad, the automobile, or electricity. It is highly unlikely, however, that future technical changes will be so much *more* capital using as to make up for the reduced rate of territorial and population growth. This is the basis on which the stagnation school predicts a long-run deficiency of investment opportunity.

III

The deficiency thesis has been attacked from several different points of view. To begin with, some writers deny the possibility of an investment problem.

[1] See especially Prof. Hansen's presidential address to the American Economic Association in December, 1938: "Progress and Declining Population," *American Economic Review*, Vol. XXIX (March, 1939), pp. 1–16.

[2] Some critics have said that the theory of secular stagnation is based on a narrow view of the peculiar difficulties experienced by this country in the second half of the thirties. This is not entirely accurate. The idea of secular stagnation runs through much of Keynes's *General Theory*, which was based on the whole postwar experience of the capitalist world. American experience, and particularly the slump of 1937–1938, did, however, focus people's attention much more sharply on the possibility of a long-run deficiency of investment demand.

Professor Henry Simons can be taken as representative of one group of these. In a recent article he characterizes Prof. Hansen's formulation of the investment problem as "mysterious," "novel," and "preposterous":[1]

Believing such things, he [Hansen] naturally urges that such a theory of dynamic development be incorporated into fundamental economic analysis, as co-ordinate with, or superior to, conventional monetary analysis and relative-price theory. Finding Hansen's revelations preposterous, I am strengthened in the conviction that the sooner we quit talking about cycle theory as a major field of inquiry, the better.[2]

And again:

Being preoccupied with saturation in some mysterious, technical sense, Hansen. . . .[3] We should be utterly skeptical about novel doctrines which explain our difficulties without reference to politically unpalatable or unmentionable facts.[4]

A brief review of classical literature from Ricardo and Mill to Taussig would show Prof. Simons, and others who hold the same view, that there is certainly nothing novel about Prof. Hansen's analysis and that it is "mysterious" and "preposterous" only in the sense that the whole classical tradition is mysterious and preposterous. Mill, for instance, says in discussing the effect of accumulation on profit:

When a country has long possessed a large net product and a large net income to make savings from and when therefore the means have long existed of making a great annual addition to capital (the country not having like America a large reserve of fertile land unused) the rate of profit is habitually within a hand's breadth of the minimum and the country therefore on the very verge of the stationary state . . . it would require but a short time to reduce profits to the minimum if capital continued to increase at its present rate and no circumstances having a tendency *to raise the rate of profit* occurred in the meantime. The expansion of capital would soon reach its ultimate boundary if the boundary itself did not continually open and leave more space.[5]

Mill clearly attaches the same fundamental significance to economic

[1] Henry C. Simons, "Hansen on Fiscal Policy," *Journal of Political Economy*, Vol. L (April, 1942), pp. 161–197.

[2] *Ibid.*, p. 163.

[3] *Ibid.*, p. 166.

[4] *Ibid.*, p. 170.

[5] John Stuart Mill, *Principles of Political Economy* (Ashley ed.), p. 731 (italics mine).

development which Prof. Simons finds so "novel" in Prof. Hansen's work.

Professor Simons' conception of "fundamental economic analysis" is evidently of fairly recent origin. As late as Taussig[1] there was no hesitation on the part of the great classical writers about including a theory of dynamic development in their fundamental analysis.

Just why Prof. Simons should want to exclude dynamic development is not at all clear. The economy we live in has for at least a century and a half been dynamic in a high degree. Techniques of production have been constantly changing, territory expanding, population growing, new products appearing, location of industry and population shifting. Leave all this out and you may have a model which is convenient for certain special purposes but which certainly has little to do with reality.

Leave dynamic development out, moreover, and the long-run outlets for new investment disappear. In excluding development, Prof. Simons is ruling out the problem he proposes to discuss.

From other passages it appears, however, that Prof. Simons does not really mean to go so far. He does not really deny the relevance of dynamic development, but merely thinks that there are enough unexploited opportunities for further development already available to last for a long time to come, even in the absence of further innovations.[2] This is, of course, quite a different story. Unfortunately, he offers not a shred of evidence in support of his "conviction" that "investment opportunities are and have been nearly limitless."[3]

An entirely different reason for denying the importance of the dynamic determinants is advanced by Dr. Moulton, Prof. W. I. King, and others. Dr. Moulton says, for example:

> Analysis of the capital and employment requirements for achieving progressively higher standards of living for the people of the United States clearly reveals the fallacy involved in the prevailing assumption that there is no further significant field of opportunity for private capital enterprise.

[1] *Cf.* particularly "Capital, Interest, and Diminishing Returns," *Quarterly Journal of Economics*, May, 1908.

[2] Simons, *op. cit.*, p. 170.

[3] *Loc. cit.* In this passage his conviction seems to rest on the difficulty of providing statistical proof of the contrary thesis, at best a weak foundation for so confident an assertion. Earlier, however, he refers to the "devastating case" that can be made out against Hansen's underlying theories (p. 162). Unfortunately the reader is left in the dark as to what the case is!

And again:

So long as there remain vast unfulfilled demands for existing kinds of goods, new products are not indispensable.[1]

Certainly no one would deny that there are plenty of opportunities for expanding the consumption and production of already familiar articles. Many millions of families, even in periods of prosperity, need more adequate clothing and food, let alone such things as washing machines, refrigerators, decent houses, medical care, recreation, and the like. It seems quite senseless to depend for full employment of our resources on the opening up of further continents, the addition of more people to the population, the substitution of airplanes for automobiles, etc., when there are so many already familiar things the existing population wants and needs in greater quantity.

Dr. Moulton's suggestion does, of course, offer a perfectly good solution for the production and employment problem. But it does not provide a solution for the investment problem. What the sharecroppers, textile workers, coal miners, etc., need is not capital but purchasing power. An insurance company or investment trust which had a superfluity of investment-seeking funds on its hands could, of course, turn the funds over to sharecroppers and other low-income consumers and thus provide them with the additional purchasing power they need. But this would not be investment. The insurance company or investment trust would not only receive no return on its capital, it would lose the principal as well.

Confusion probably arises from the fact that, as a result of an increase in consumer demand, additional capacity might be required in the consumer-goods industries. If insurance companies and other investors turned part of their incoming funds over to sharecroppers, and the sharecroppers spent the money on clothes, the clothing and textile industries might find it necessary to enlarge their capacity and might have to appeal to investors for funds. Thus by giving away part of their savings, investors might provide an investment outlet for the rest. But even this partial outlet would be only temporary. Once the new capacity had been com-

[1] Harold G. Moulton and others, *Capital Expansion, Employment, and Economic Stability* (Washington, 1940), pp. 193 and 182. Essentially the same argument is advanced by W. I. King, *Journal of Political Economy*, Vol. XLVII (October, 1939), p. 617, and Howard S. Ellis, "Monetary Policy and Investment," *American Economic Review*, Supplement. Vol. XXX (March, 1940).

pleted, replacement would be financed out of depreciation allowances. Net investment would again sink to zero. In order to provide themselves with a further outlet, investors would have to give away still more of what investment income they had left (the original gift being repeated of course in each succeeding income period, otherwise consumer demand would sink back to its original level). In the absence of dynamic changes, investment would approach zero. This is surely not what Dr. Moulton, Prof. King, and others had in mind in proposing increased consumption as a solution to the investment problem.

IV

Other critics of the stagnation theory fully realize the importance of economic development for investment opportunity but confine their attention to one element in it, *viz.*, technological innovation. Professor Schumpeter, for instance, leaves population growth entirely out of his theory of economic development.[1] Professor Slichter talks about both change and growth as determinants of investment,[2] but when he comes to discuss the depression of the thirties and the problems of the postwar period, he lets growth fade into the background and makes technological progress the all-important factor.[3] Since Prof. Schumpeter and Prof. Slichter, and the many others who agree with them, are able to dismiss growth as of little or no importance, they can conjure up optimistic pictures of the future prosperity which private investment would produce if only it were freed from social and political shackles.

Professor Slichter suggests that technological change may be even more important from an investment point of view in the future than it has been in the past (p. 11). "More important" must mean relative to society's power to accumulate capital. In other words, Prof. Slichter expects a continual succession of changes more revolutionary in their effects on the economy than the introduction of steam and of the railroad in their day. The history of the last 150 years points in the opposite direction. As industriali-

[1] Joseph A. Schumpeter, *Theory of Economic Development* (Cambridge, 1934).

[2] Sumner H. Slichter, *Towards Stability* (New York, 1934).

[3] "The Conditions of Expansion," *American Economic Review*, Vol. XXII (March, 1942), pp. 1–22. Professor Slichter says at one point: "Of course, it would have helped had there been another Mississippi Valley to develop" (p. 2). But he apparently does not think that the lack of a Mississippi Valley to develop could have hindered expansion in any way.

zation has proceeded, its effects, relatively speaking, have become less, not more, revolutionary. There has, in fact, been a general progression in industrial communities from a deficiency to a surplus of capital relative to internal requirements.

The relation between growth and investment opportunity has a certain elusive quality about it which makes satisfactory analysis difficult. Perhaps this is one reason it has received relatively little attention from economists. From one point of view it seems quite clear; from another extremely obscure. Viewed historically, for instance, the whole thing seems rather simple. Over the last 150 years there has been a tremendous growth both in the population and in the territory of the capitalist economies. An enormous amount of capital has been invested in equipping the additional people with factories, farms, railroads, houses, power plants, etc. This investment has not had to wait on the invention of better machines or new methods of transportation or cheaper houses but has gone into building more of the already existing types. If there had not been any increase in population, capital would have had only the outlets provided by the substitution of new equipment and new products for the old. The total volume of investment would have been very much less, perhaps not more than half what it has been.

If at the same time capital had tended to accumulate as rapidly as it has, there would have been tremendous pressure on the available investment outlets and the rate of return would have been continually sinking to the minimum investors were willing to accept. This would have meant a chronic tendency to depression and unemployment, *i.e.*, secular stagnation.

It is probably unrealistic to assume that the (potential) rate of accumulation would have been as rapid had there never been any growth of population and territory. But if the growth had gone on for some time, wealth had accumulated, and the community's propensity to save become adjusted to a high rate of investment expenditure, it is not at all unrealistic to assume that the higher (attempted) rate of saving would have continued for a long time. The actual rate, of course, would have been kept in check by low income.[1]

[1] The classical economists thought that population growth would continue in response to accumulation of capital until both were checked by diminishing returns from land. But their analysis can also be applied to an autonomous cessation of growth. Ricardo admitted this in a letter to Malthus:

"You say that you think that I have sometimes conceded that if popula-

From the historical point of view the relation of growth and investment seems clear enough. If there had been less growth there would have been less investment. But once society has become geared to a certain rate of investment, it does not easily adapt itself to a lower rate. Thus a significant slowing down in the rate of growth is likely to cause serious economic difficulties.

A more detailed analysis of the causal relation between growth and investment, however, raises difficult theoretical problems. It seems paradoxical that a lower rate of population growth should cause unemployment. If more workers will stimulate investment why will not unemployed workers do the same?

The question becomes even more puzzling when we introduce wages into the analysis. According to classical theory, population growth is favorable to investment because it moderates the rise in wages which would otherwise take place with advancing accumulation. By keeping wages in check it enables accumulation to continue without a fall in the rate of profit. This leads naturally to the conclusion that if unemployment fails to stimulate investment it is because wages are too high. Let unemployment have its proper effect on wages and investment will be increased, income and output will rise, and unemployment will disappear.

But even if the reduction in wages encouraged employers to hire more labor and in the process of hiring more labor to increase investment outlays, the stimulus to income and hence to employment would at best be temporary. For as soon as all the unemployed had been hired and provided with the appropriate capital equipment, investment in providing the unemployed with capital equipment would obviously cease. In the absence of an offsetting increase in the propensity to consume, or in other types of investment, the result would be a new decline in income and in employment. Hiring the unemployed, even assuming that it was accompanied by a significant amount of new investment, would thus provide at most

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tion were miraculously stopped, while the most fertile land remained uncultivated, profits would fall upon the supposition of an increase of capital still going on. I concede it now. Profits I think depend on wages—wages depend on demand and supply of labour, and on the cost of the necessaries on which wages are expended. . . . In the case you put, wages would have a tendency to keep stationary as far as the supply of food was concerned, but they would have a tendency to rise in consequence of the demand for labour increasing, whilst the supply continued the same. Under such circumstances profits would of course fall. You must, however, allow that this is an extraordinary case."—Ricardo, *op. cit.* p. 98.

a temporary cure for unemployment. It would not be a complete cure even temporarily since the amount of investment required to outfit the unemployed with new capital equipment would necessarily begin to fall off before full employment had been reached.

Thus we arrive at the paradoxical conclusion that an attempt on the part of employers to hire all the unemployed will not necessarily eliminate unemployment. The difficulty of finding satisfactory answers to problems such as this has led many economists to drop population growth from their analysis of the factors influencing investment and employment. But, while this may seem like an easy way out, it solves no problems. Progress in understanding can come only through an acceptance of the theoretical challenge. Meanwhile, even though we do not have answers to all the theoretical questions involved, it seems safe to stick to the commonsense historical conclusion that population and territorial growth have had a large influence on investment and that a reduction in the rate of growth is bound to affect investment adversely.

It has been suggested that population growth may be more a supporting than an initiating force in relation to investment.[1] Continued increase in population in a period of depression and large-scale unemployment might have little effect beyond increasing still further the number of unemployed. But once expansion had started, as a result of the introduction of new techniques or the opening up of new resources, employment would increase and the expansion would be reinforced by the investment involved in putting the additional people to work. The expansion furthermore would last longer if population went on increasing than if the supply of new workers was exhausted with the absorption of the unemployed.

The concept of secular stagnation does not imply stability at a fixed, low rate of production. A secularly stagnant economy might well be characterized by even more violent fluctuations than the predominantly prosperous economy of the nineteenth century. The difference is in the norm around which the fluctuations would occur. A stagnant economy would be characterized by long and severe depressions and brief, anemic recoveries, in contrast to the strong prosperities and mild depressions of the past.[2] Even aside from

[1] This possibility is discussed in my article on "Population Growth and Investment Opportunity," *Quarterly Journal of Economics*, Vol. LV (November, 1940), pp. 73*ff*.

[2] Hansen, *op. cit.*, p. 4.

war and reconstruction, a stagnant economy would undoubtedly experience periods of expansion. The rate of technical innovation is likely to be quite uneven, and the bunching of new techniques, new products, etc., would from time to time give rise to enough investment to carry income and employment to reasonably high levels. But the expansion, lacking the support of growth, would tend to give out sooner and to be followed by a longer, more severe depression than in a rapidly growing economy.

Discussion of growth often suffers from lack of perspective. It is said, for instance, that territorial expansion cannot have any relation to the depression of the thirties since the frontier had disappeared as far back as the 1890's. The trouble with this argument is that it considers the frontier an exclusively American phenomenon. Actually the frontier is worldwide.

The frontier in the United States disappeared in the 1890's, and, as a result, exploitation of other "frontiers," Canada, Latin America, Africa, and Asia, was greatly intensified. English capital, which had hitherto played an important role in the development of this country, bore the brunt of the shift.

By the 1920's this country had also developed a surplus of capital over home requirements and had joined the search for new outlets abroad. Relatively speaking, the openings in still undeveloped parts of the world were much less abundant than they had been in the nineteenth century. If it had not been for the temporary weakening of the accumulative power of England, France, and Germany, and the demands of war reconstruction, the discrepancy between the amount of capital seeking investment abroad and the available outlets would have showed up even sooner than it did.

It is possible that the rate of development of economically "backward" countries, particularly in Asia, will be faster after this war than after the last and that Western capital will be able to secure an important role in it. But there is little ground to expect anything approaching in relative magnitude the outlet English capital found in America in the nineteenth century.[1]

[1] The industrialization of Asia may well follow quite a different pattern from that of America. Natural resources are probably less bountiful, rates of return are likely to be lower, much broader planning and coordination may be necessary, established social and political institutions may to some extent present obstacles, the nations concerned may be unwilling to have foreign capital play a predominant part in their development.

V

The stagnation school is commonly accused by its critics of neglecting social and political changes which have had an unfavorable effect on investment. Higher income and profit taxes and the growth of labor organization are usually cited as the most important. Actually, writers of this group not only have been aware of these developments but have also pointed out that they are likely to aggravate investment difficulties. They are convinced, however, that political and social changes are manifestations rather than fundamental causes of the economic crisis of the modern world.

It is particularly important to determine which are causes and which effects, because the appropriate remedies differ sharply. If the basic trouble is a lack of sufficient investment opportunity, the only basic remedy is an increase in the propensity to consume. Attempts to stimulate investment would by themselves yield meager results. It is impossible to stimulate anything beyond the limit of what is there to be stimulated. With a basic deficiency of investment outlets, no amount of social and political "coddling" of investors will produce enough investment expenditure to keep income and employment at satisfactory levels for any appreciable length of time.

Increasing the community's propensity to consume, on the other hand, necessarily involves measures designed to redistribute income from savers to consumers, increase in the political power of low-income groups, etc. These, unfortunately, are the very things about which investors complain so bitterly. Thus, a policy of increasing the propensity to consume unavoidably conflicts in considerable measure with a policy of encouraging private investment. Insofar as the two policies are mutually exclusive, the choice between them must, of course, rest on which one will contribute more to the long-run effectiveness and stability of the economic system.

It is often said that the stagnation theory is pessimistic, defeatist. This is true only from the point of view of those who regard investment as an end in itself. If, on the other hand, we take seriously what we learned and what we teach in elementary economics, *viz.*, that consumption is the final aim of economic activity, the implications of the stagnation theory are optimistic not pessimistic. If the theory is correct, it means that society can devote a

larger proportion of its resources in the future to satisfying current consumer wants, including such things as the provision of more adequate medical care, better housing, wider educational opportunities, etc. This is certainly anything but a gloomy prospect. People have trouble in seeing it in its true light only because they are still thinking in terms appropriate to a scarcity rather than an abundance of capital.

Chapter V

POSTWAR PRIVATE INVESTING AND PUBLIC SPENDING

Richard Bissell

Since 1932, socialism, under that name, has not been a live political issue in the United States.[1] What the radicals of these latter days have argued is that a system of free enterprise, left to itself, would not and could not be expected to function with even tolerable success. In their view, it is not the existence of private property nor the selfishness of the profit motive, nor even the unregulated competition of firms and industries that is the basic cause of the trouble but, rather, the peculiar instability of the income flows in a wholly free economy with a modern monetary system. Their diagnosis emphasizes the absence of any reliable mechanism for ensuring that, when a large output of goods and services is produced, sufficient markets will be created by the act of production to absorb the whole output.

What they prescribe is deliberate action by the government to supplement incomes and thus enlarge the market when it appears to be too small and (though this received less attention from them until the war began to make itself felt) to limit or absorb income and thus cause the market to contract when it is in danger of becoming too strong. It is the function of the government, in short, to act as a financial balance wheel in a free-enterprise economy by spending as much and as continuously as necessary. The budget should not be balanced; theoretically it should show a surplus or a deficit according as the economy requires a sedative or a stimulant, but the latter is what will usually be called for. Whether such a fiscal policy is sound, whether the government can afford to run a perpetual deficit, is the public spending issue.

A major argument against public spending is that it may involve the neglect by the government of other activities that are fully

[1] This essay is based on articles published in *Fortune* in May and June, 1942. Permission has been granted by the editor of this magazine to use this material.

as necessary for the health of a free-enterprise system. The classic function of the government in a free-enterprise economy is to establish and maintain the institutional and legal environment in which economic decisions are made. This does not imply a passive role. From time to time public and private institutions and policies develop in such a way that environmental conditions become unfavorable to economic activity. This may occur through the growth of monopoly in business or of a structure of labor policies that hamper innovation. It may occur as a result of the technological backwardness and irrational organization of a critical industry, such as the construction industry. It may take the form of the slow development of a tax structure which penalizes consumption and enterprise. Even a rapid increase in public (or private) debt may play the same part.

Whenever such unfavorable conditions do appear, one way of stimulating economic activity is through their removal. Yet a government which is preoccupied with spending and which is determined to spend whatever sum is necessary to achieve a high level of economic activity is not, in fact, likely to push fundamental changes. Though the strongest advocates of public spending agree readily that economic policy in all other directions *should* be designed to minimize the need for it, spending often serves to cover up failure on other fronts and is used to excuse it. Public spending does not compete with other economic activities for the use of resources (unless it is continued after reasonably full employment has been reached). But a spending *policy* does compete with other public and private *policies*. This is the crux of the issue.

The case for public spending can best be stated (and usually is) in terms of the Keynesian analysis of income flows. Keynes's great "discovery" (as he, himself, claimed) was that decisions to save and decisions to invest (in the Keynesian sense, *i.e.*, to make capital expenditures) are made by different sets of people at different times and for different reasons and often get out of step. The consequences of such a maladjustment can be serious. If the savers attempt to increase their saving and thereby to save more than the investors are currently investing, they can do so only by reducing their expenditures. This means that current receipts in the whole community decline; saving is cut by the drop in business and by unexpected reductions in consumers' incomes. The reduction in consumers' incomes and the decline in sales causes further successive reductions in spending and in current receipts. This process con-

tinues until the savers are no longer trying to save more than the investors are prepared to invest. Of course, such a deflation may also affect the behavior of the latter. If they curtail their capital expenditures, the reduction in production and in incomes has to go further before the amount people try to save is so reduced that it catches up with the shrinking total of capital expenditures. Thus a high rate of investment sustains a high national income, and the attempt to save makes its attainment more difficult.

What is wrong with this line of reasoning is that, as an unrestricted generalization, it proves too much. After all, the United States did get through a century and a quarter of capitalist development with a remarkably good record. The weak links in the chain, then, must be related to the Keynesians' minor premise, *i.e.*, to their belief that these conclusions have been applicable to the United States in the decade of the thirties and will again be applicable to the United States at the end of the war. The first and the most serious real issue involved, therefore, concerns the nature of the concrete historical situation in whatever nation and period is under discussion, specifically, the circumstances that affect investment incentives and habits of saving.

The second real issue has to do with the effects of policies and of institutional arrangements upon economic decisions. The critics of the Keynesian position have consistently argued that the volume of private capital expenditure in the thirties was not irrevocably determined by immutable circumstances nor, yet, by the low level of current income. (All revivals begin in depressions. The *persistence* of depression obviously cannot be accounted for by its existence to begin with.) They blame policy, public policy mainly, to be sure, but various sorts of private policy as well. The trouble may have been, not an excessive rate of saving nor an unalterably low rate of private investment, but a set of policies that inhibited investment.

If there is not going to be enough investment, given our habits of saving, to sustain a high national income, then thrift causes poverty, and public spending prevents waste (the waste of resources). But the "if" leaves two issues open still. First, men disagree in their appraisal of the objective conditions that must be taken as given, especially as they relate to saving and to investment opportunities. Second, they disagree on the part played by policy in determining the volume of capital expenditures.

THE LAMENTABLE THIRTIES

Both of these questions arise in any analysis of the thirties. To the Keynesians the great depression signalized the major break in American economic development. Prior to that time, they admit opportunities for private investment had, on the average, been adequate to maintain reasonably full employment in a reasonably high level of economic activity with, of course, fairly frequent depressions that could be explained by special or temporary circumstances. But 1929 marked the end of this era. Thereafter we might expect to suffer from a secular stagnation due to a chronic deficiency of investment opportunity as well as from the deep depressions associated with cyclical fluctuations.

A variety of factors were listed as the causes of so momentous a change. The country is becoming mature; there is no longer any geographical frontier that has a significant influence on American economic development. The rate of population growth fell off sharply after 1929. Changes in technology have been of a predominantly "capital-saving" character; that is to say, they permit the maintenance or expansion of output with a smaller plant and fewer machines, *i.e.*, smaller capital costs than formerly. Finally, no major new industry, such as the automobile industry, appeared after 1929 to sustain investment. It is not easy to appraise all these issues separately. The changes to which they refer did actually occur but it is not so certain that they explain the observed course of events.

The absence of a geographical frontier during the thirties cannot be denied, but it had pretty largely disappeared 30 years before the onset of the great depression. The difference between the twenties and the thirties can hardly be explained on this basis. The concept itself is somewhat nebulous when closely examined. A geographical frontier is significant economically because it implies the existence of unexploited physical resources. If a new railroad is to be built to permit opening up a new mine, investment is stimulated. In other words, it is new resources, not just new areas, that are important. But when this is realized, it becomes even harder to establish a contrast between the twenties and the thirties. It was in the latter decade that we at last learned how to use southern pine as the raw material for paper products on a large scale. The discovery of new oil reserves proceeded at a far faster rate during the thirties than during the twenties. And even in the

depressed coal industry, new mines and fields continued to be opened up. A shortage of new resources will hardly account for secular stagnation.

The effect of population growth upon investment incentives is both a complex and a controversial matter. But the arguments advanced by Hansen, Myrdal, and others are at least open to serious questions. A mere increase in the size of the population does not automatically ensure that the market for consumers' goods is going to be larger in dollar terms and the incentive for capital expenditure correspondingly greater. A decline in the rate of population growth may have made people spend a smaller proportion of their incomes (and save a larger) and it may have changed the direction of demand. But even Hansen now concedes that it could have made relatively little difference in the amounts people spent out of given incomes. If the drop in the rate of population growth had any effect it was via the direction not the absolute size of demand. In particular, it may have reduced the demand for houses. But this argument runs into another difficulty, for the rate of growth in the number of families did not drop significantly between the middle and late twenties and the middle thirties. The thirties cannot very easily be explained, therefore, by a reference to population.

The argument about changes in technology is harder to evaluate but it is notable that expenditures for equipment recovered remarkably well during the thirties in view of the lower level of prices and the smaller size of the national income. Indeed, when equipment expenditures are plotted against gross national expenditure (a measure of the output of goods and services valued at market prices, analogous to but somewhat larger than the national income) and when the two are correlated, equipment expenditures do not show a declining trend through time. The evidence is clear that our failure to achieve full recovery in 1936–1937 was not due to the small size of expenditures on equipment.

The stagnation of private investment in the thirties is mainly attributable to the persistently small volume of construction. In the most prosperous years between 1930 and 1940, housing remained below the level of 1921 and never came close to 50 per cent of the smallest figure for annual construction between 1923 and 1928. This was in spite of the fact that national income in 1937, 1939, and 1940 was close to the level reached in the middle twenties. It would be tempting to explain the small volume of housing by reference to

the low rate of population growth were it not for the well-sustained rate of growth in the number of families referred to above. The small volume of business construction, especially factories and public utilities, may reflect the capital saving character of technological changes. American industrialists learned to produce a substantially larger output on a given floor space and, even where the capital investment in machinery kept pace with output through the thirties, the investment in plant did not. But when all due credit is conceded to the explanations that the Keynesians have advanced, the stagnation of the thirties remains far from fully explained.

ECONOMIC MATURITY

One other type of evidence may be quoted to suggest that the maturity of the American economy may not have been the major cause of its wretched performance between 1929 and 1939. Practically every nation in the world felt the impact of the great depression in 1930, 1931, and 1932. But it is notable that other nations with far more maturer economies achieved a far more complete recovery thereafter. England and Sweden are two of the clearest examples.

To be sure, international comparisons are always dangerous and Hansen has given an able explanation of England's peculiarly happy experience. He argues that the fall in the price of imports and especially of imported foods, the temporary stimulus to internal investment provided by newly imposed tariffs, and the private housing boom (itself partly due to the first two factors) were the proximate causes of Britain's prosperity until the rearmament program began.

But perhaps even this record contains certain lessons for us. It may be, for example, that we would have done better to have safeguarded the interests of consumers by managing farm relief in such a way as not to raise the cost of living. As for Britain's housing boom, the analysis of it which appeared in the London *Economist* of Nov. 10, 1934, conceded that cheap money and relatively low costs of materials have a good deal to do with it. We did finally achieve cheap money through the Federal Loan Agencies. But the real estate credit structure in the United States proved itself far weaker than the British in the depression and we entered upon the period of recovery with no wealthy and well-established building societies to finance private construction. Finally, it is just barely possible that businessmen were more willing to build new plants in the

automobile industry and the light consumers' goods industries that sprang up in southern England because the political climate was more favorable to enterprise. And it is possible, too, that businessmen were relieved of certain fears because Britain already had a powerful, recognized, stable labor movement.

If, then, the explanations of the Keynesians are, to put it mildly, incomplete, we may be permitted at least to explore the possibility that the phenomenon of the thirties can be explained on other grounds. Certain partial explanations are implicit in the above comparison between British and American experience. The process of building up labor organizations and of securing the acceptance of collective bargaining as the normal method of determining the employment contract must have been disturbing to profit expectations. This does not imply, of course, that no attempt should have been made to promote collective bargaining. There is no question here of assessing responsibility. Business paid in the thirties the cost of its previous refusal to deal with unions. But it was a major misfortune, if not an avoidable one, that the price had to be paid at that particular time. It is as absurd for the reformers to argue that such things have no influence upon investment decisions as it is for their opponents to argue that the reforms should never be made because they will have a depressing effect upon private investment when they are first instituted. From the economists' point of view, all that is relevant for the question here under discussion is that an unfriendly political climate and the unrest in the labor market may explain in part the failure of long-term investment to revive.

Both the business community and labor-union leadership share the responsibility with the government for certain other policy decisions that may have been important. It is fair to say that the whole decade was characterized by the effort of organized producers to raise their incomes at the expenses of the buyers of their products. A generally lower level of prices and costs might have been healthier than that which prevailed. But what is more important is the fact that certain cost-price relationships appear to have been out of line. As pointed out above, housing was too expensive in relation to other goods. Labor in certain particular industries, notably the housing industry throughout the decade and the automobile industry at the end of the decade, was probably too costly in relation to labor in general. These policies may, of course, be regarded as symptoms of the maturity upon which the Keynesians blame the semidepres-

sion of those years. But their critics have a perfect right to reply that it is not legitimate to describe certain policies as evidence of a secular trend and call for public spending instead of for a change in those policies.

These alternative explanations are not, by themselves, sufficient. Nor do they controvert those offered by the Keynesians. But they differ from the latter in that they are either inherently temporary or else directly related to public and private policy and, therefore, potentially temporary. The housing cycle will not always be in its low phase, so the low rate of construction in the thirties is not conclusive evidence of an enduring state of affairs. There is no inherent necessity for labor policy and price policy to be always unfavorable to investment. Insofar as the stagnation of the thirties was due to policy or to temporary factors, it cannot be blamed upon irresistible and irreversible changes in the economic environment. In a longer perspective, the thirties may turn out to be a depressed decade separating two long periods of high investment activity.

Whether they do depends upon what happens in the years after the war, and, superficially the prospects seem far from favorable. Yet, neither the precedent of 20 years ago nor reflection on the economic nature of war lends support to pessimism. True, production may be halted abruptly in all war industries at the end of hostilities. But the war will have the same effect on income (even after taxes) as a major boom, but the effect upon expenditures and upon stocks of durable goods as a major depression. Unless there is a major economic catastrophe, the scene will have been laid, during the war, for a large, perhaps dangerously inflationary, increase in civilian buying.

At the end of the First World War, it turned out that the incentives for consumer spending and private investment were (as everyone had taken for granted that they would be) strong enough to justify a conservative fiscal policy for 10 years. From the autumn of 1918 until the spring of 1919 there was an incipient depression. But throughout the balance of 1919 and the beginning of 1920, the wartime boom continued with disastrous vigor. The 1921 depression was severe but brief. Significantly, it did not halt the heavy capital expenditures for plant and equipment that commenced soon after the end of the war. By 1922 the great housing boom of the twenties was under way and the New Era was launched.

No doubt, it would be just as dangerous to answer the fundamental question about the postwar years by pointing to the analogy of the twenties as to give free rein to the depression psychology of the thirties. But the experience, first, of the 1919–1920 inflation, second, of the 1922–1929 boom, and, third, of what has happened since 1929 does suggest that there are not one but three separate postwar problems.

The first relates to the immediate transition, the year that corresponds to 1919, the second to the ensuing 4, 5, or 6 years, and the third to the more remote and more uncertain future, the long run, that lies beyond. How the first should be handled, what it will be possible to achieve in the hectic months of demobilization depends upon the prospects for the longer run and the objectives the nation chooses to pursue, even though the events of the transition will themselves modify the long-run outcome. Therefore, the great question is whether there can be another huge and long-sustained recovery, whether the twenties will be repeated.

The third problem is simply what will happen thereafter. Here we are mainly concerned with the second phase. It presents a manageable economic problem. Even so, unconditional forecasting is out of the question. One reason is that prediction is quite impossible when the course of human events depends so largely upon military and political developments. The other and basic economic reason is that the level of economic activity after the war both depends upon and determines civilian demand. It depends upon the market but determines employment, consumer income, and, thus, investment incentive.

The only way out is to take firm hold of one of the horns of this dilemma. Let us arbitrarily assume that economic activity and, therefore, consumer income are, in some fashion, maintained close to their wartime level and inquire whether consumption and capital expenditures will, given this postulate, be sufficiently large to provide a market for the output that will be produced.

To ask the question in this form does not involve assuming away the problem. If the pessimists are correct, the answer will turn out to be in the negative. Indeed, their whole contention is that, if we produce a large output, private capital expenditures will not be large enough to absorb that part of the proceeds from the sale of output left over in the form of savings after consumers' expenditures.

Basic Assumptions.

The first step in developing an answer is to put the assumption of a high national income into specific quantitative terms and to build, on this foundation, a model of a postwar year. It is obviously desirable to set up the model in terms of measures of economic activity, consumption, and capital expenditures and saving which will make possible comparison with past years. Tables 1 and 2 embody a statistical picture of the structure of the output of goods and services and of the flow of income in the United States by calendar years since 1929, projected to cover fiscal 1943 and a postwar year. Table 1 gives a breakdown of all expenditures for finished goods and services into government expenditures, capital expenditures, and consumers' purchases of consumer goods. Table 2 shows the way in which the proceeds of the sale of goods and services were disposed of in the form of taxes, savings, and consumer expenditures. The picture of fiscal 1943, which is in terms of 1941 prices, represents a mixture of assumptions and derived estimates. The basic assumption is that total production expands and civilian production contracts sufficiently so that the goals outlined in the President's original war program are really attained, which would require a gross national expenditure in the neighborhood of $132 billion.

This figure is worth considering as a benchmark for a postwar year. There is no doubt that gross national expenditure will rise higher if the war continues and maximum employment of both people and other resources is attained. But it is also true that peacetime prosperity should be predicated on a normal work week and a normal labor force, which implies an output well below the war maximum. Therefore, the postulate of a high national income in the years after the war may appropriately be made concrete by assuming that gross national expenditure will continue at the rate of $132 billion per annum.[1]

What is necessary, next, is to put in concrete form an assumption as to the scope of government activities, measured by taxes and public expenditures. Then the problem will be to determine how the total of $132 billion, viewed as the proceeds derived from the sale of goods and services, is likely to be disposed of in the form of taxes (already determined by the assumption about government),

[1] Cf. the informed guesses of Profs. Hansen and Samuelson in this volume.—EDITOR.

TABLE 1.—COMPOSITION OF GROSS NATIONAL EXPENDITURE, 1929–1941, FISCAL 1943, AND POSTWAR ESTIMATES
(Billions)

	1929	1930	1931	1932	1933	1934	1935	1936
Government:								
State and local	$ 8.3	$ 8.8	$ 8.7	$ 7.8	$ 6.5	$ 5.9	$ 8.0	$ 8.0
Federal: Ordinary	2.7	2.4	2.8	2.4	2.6	4.9	3.9	4.6
War								
Total government	$11.0	$11.2	$11.5	$10.2	$ 9.1	$10.8	$11.9	$12.6
Investment:								
Equipment: capital outlay charged capital account	6 5	5.2	3.6	2.0	1.7	2 6	3.4	4.4
Capital outlay charged current expense	0.8	0.8	0.6	0.4	0.4	0.5	0.6	0.8
Construction: residential	3.6	1.8	1.5	0.6	0.4	0.6	0.9	1.4
Factory and public utility	2.4	2.0	1.2	0.6	0.4	0.5	0.5	0.8
Other	2.3	1 8	1 1	0.6	0.5	0 5	0.7	0.7
Net foreign balance	0.6	0.7	0.2	0.2	0.2	0.5	0.2	−0.1
Net change in inventories	1.4	−0.3	−1 8	−2.2	−0.7	−0.7	0.3	1.9
Domestic purchases of monetary metals	0.0	0 1	0.0	0.0	0.0	−0.1	0.1	0.1
Deferred producers' demand								
Total capital expenditure	$17.6	$12.1	$ 6.4	$ 2.2	$ 2.9	$ 4.4	$ 6.7	$10.0
Consumption:								
Consumers' durable	9.9	8.1	6 3	4.2	3.4	4.8	5.7	6.7
Consumers' nondurable	60.9	56.8	47 9	38 0	39.4	43.8	46.5	52.4
Total consumers' expenditure	$70.8	$64.9	$54.2	$42.2	$42.8	$48.6	$52.2	$59.1
(Less) Surplus								
Gross national expenditure	$99.4	$88.2	$72.1	$54.6	$54.8	$63.8	$70.8	$81.7

TABLE 1.—COMPOSITION OF GROSS NATIONAL EXPENDITURE, 1929–1941, FISCAL 1943, AND POSTWAR ESTIMATES.—(*Continued*)

	1937	1938	1939	1940	1941	Fiscal 1943	Postwar
Government:							
State and local	$ 7.5	$ 7.6	$ 8.3	$ 8.3	$ 8.2	$ 7.0	$ 8.0
Federal: Ordinary	6.1	6.8	5.4	5.5	5.2	4.5	7.5
War			1.4	2.5	9.6	53.0	
Total government	$13 6	$14.4	$15.1	$16.3	$ 23.0	$ 64.5	$ 15.5
Investment:							
Equipment: capital outlay charged capital account	5.5	4.0	4.6	5.6	7.1	2.5	9.0
Capital outlay charged current expense	0.8	0.5	0.8	1.0	1.8	0.5	1.2
Construction: residential	1.7	1.8	2.1	2.3	2.7	0.5	5.2
Factory and public utility	1.1	0.7	0.8	1.1	1.4	0.8	2.0
Other	0.9	0.8	0.8	1.0	1.1	0.2	3.0
Net foreign balance	0.1	1.1	0.8	1.4	0.9	0.5	1.5
Net change in inventories	1.3	−1.3	1.1	1.9	3.9	−1.5	1.5
Domestic purchases of monetary metals	0.2	0.1	0.0	0.3	0.2	0.0	0.2
Deferred producers' demand							1.0
Total capital expenditure	$11.6	$ 7.7	$11.0	$14.6	$ 19.1	$ 3.5	$ 24.6
Consumption:							
Consumers' durable	7.6	6.0	7.1	8.3	10.3	3.0	14.5
Consumers' nondurable	54.9	52.5	54.9	57.9	65.5	61.0	78.8
Total consumers' expenditure	$62.5	$58.5	$62.0	$66.2	$ 75.8	$ 64.0	$ 93.3
(Less) Surplus							1.4
Gross national expenditure	$87.7	$80.6	$88.1	$97.1	$117.9	$132.0	$132.0

TABLE 2.—DISPOSITION OF GROSS NATIONAL EXPENDITURE, 1929–1941, FISCAL 1943, AND POSTWAR ESTIMATES
(Billions)

	1929	1930	1931	1932	1933	1934	1935	1936
Corporate saving:								
Net corporate saving	$ 1.2	$−3.9	$−5.8	$−6.4	$−2.8	$−2.1	$−1.3	$−0.9
Capital outlay charged current expense	0.7	0.7	0.5	0.3	0.3	0.4	0.5	0.7
Corporate depreciation and other reserves	5.3	5.5	5.5	5.2	5.1	4.9	4.7	4.9
(Less) corporate inventory revaluation	0.4	3.0	2.2	0.9	−1.5	−0.8	−0.5	−0.3
Gross corporate savings	$ 7.6	$ 5.3	$ 2.4	$ 0.0	$ 1.1	$ 2.4	$ 3.4	$ 4.4
Business taxes:								
Corporate income and profit taxes	1.4	0.9	0.6	0 5	0.6	0.8	1.0	1.5
Other business taxes	5 6	5.9	5.6	5 6	6.0	6.7	7.1	7.3
Total business taxes	$ 7.0	$ 6.8	$ 6.2	$ 6.1	$ 6.6	$ 7.5	$ 8.1	$ 8.8
Personal taxes:								
Personal taxes	3.0	2.6	2.4	1.9	1.8	1.9	2.3	2.9
(Plus) employment taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.6
(Less) transfer payments	−0 7	−0.7	−1.9	−1 3	−1.4	−1.5	−1.8	−2.9
Net taxes on individual income	$ 2.5	$ 2.1	$ 0.7	$ 0.8	$ 0.6	$ 0.6	$ 0.7	$ 0.6
Disposable income:								
Gross personal saving	11.5	9.1	8 6	5.5	3.7	4.7	6.4	8.8
Consumption expenditure	70.8	64.9	54 2	42.2	42 8	48.6	52.2	59.1
Gross disposable income	$82 3	$74 0	$62.8	$47.7	$46 5	$53.3	$58.6	$67.9
Gross national expenditure	$99.4	$88.2	$72.1	$54 6	$54.8	$63.8	$70.8	$81.7
Gross saving (corporate and personal)	19.1	14 4	11.0	5.5	4.8	7.1	9.8	13.2

TABLE 2.—DISPOSITION OF GROSS NATIONAL EXPENDITURE, 1929–1941, FISCAL 1943, AND POSTWAR ESTIMATES.—(*Continued*)

	1937	1938	1939	1940	1941	Fiscal 1943	Postwar
Corporate saving:							
Net corporate saving	$−0.8	$−1.5	$ 0.4	$ 1.3	$ 2.6	$ 3.5	$ 1.4
Capital outlay charged current expense	0.7	0.4	0.7	0.8	1.5	0.5	1.2
Corporate depreciation and other reserves	4.7	4.2	4.6	4.8	5.7	7.5	6.5
(Less) corporate inventory revaluation	−0 6	0.7	−0.2	−0.3	−2 6	−0.5	
Gross corporate savings	$ 4.0	$ 3.8	$ 5.5	$ 6.6	$ 7.2	$ 11.0	$ 9.1
Business taxes:							
Corporate income and profit taxes	1.6	1.2	1.5	2.8	5.2	9.5	3.5
Other business taxes	7.4	7.1	8.1	9 0	10.8	11.5	6.5
Total business taxes	$ 9.0	$ 8.3	$ 9.6	$11.8	$ 16.0	$ 21.0	$ 10.0
Personal taxes:							
Personal taxes	3.1	3.3	2.9	3.0	3.8	10.0	4.0
(Plus) employment taxes	1.7	1.9	2.0	2.2	2.6	4.0	4.0
(Less) transfer payments	−1.7	−2.4	−2.5	−2.6	−2.4	−2.7	−3.0
Net taxes on individual income	$ 3.1	$ 2.8	$ 2.4	$ 2.6	$ 4.0	$ 11.3	$ 5.0
Disposable income:							
Gross personal saving	9.1	7.2	8.6	9.9	14.9	24.3	14.6
Consumption expenditure	62.5	58.5	62.0	66.2	75.8	64.4	93.3
Gross disposable income	$71.6	$65.7	$70.6	$76.1	$ 90.7	$ 88.7	$107.9
Gross national expenditure	$87.7	$80.6	$88.1	$97.1	$117.9	$132.0	$132.0
Gross saving (corporate and personal)	13.1	11.0	14.1	16.5	22.1	35.3	23.7

corporate and personal savings, and consumption. These two steps will result in figures for government demand and consumer demand. The last step will be to assess quantitatively the prospects for private investment (under the assumed conditions) and thus decide whether the total demand for goods and services that would be generated by a gross national expenditure of $132 billion would give rise to this volume of spending.

The assumptions about government should be reasonable on the basis of precedent, yet actual prediction would be of no help, even if it were possible. The whole purpose of the inquiry is to discover whether it is going to be possible to maintain economic activity at a high level in the absence of heavy deficit spending by the government. The only proper course, therefore, is to assume arbitrarily that the government deficit is at least reduced to small proportions and that total government expenditures are going to revert to something fairly close to their prewar level.

During the twenties Federal fiscal policy was conservative but states, municipalities, and other local units of government were making capital expenditures at a rate that more than offset Mr. Mellon's surpluses. The excess of all public expenditures (Federal, state, and local) over receipts averaged close to $500 million per annum. It would be visionary to hope that with a larger population, national income, government structure, and public debt, public expenditure can be reduced to the prewar level. And even those who are hoping wistfully that the public debt can be reduced after the war might be satisfied if the fiscal history of the twenties could be repeated. Therefore, with an eye on the past we shall assume state and local expenditures of $8 billion, Federal expenditures of $7.5 billion, corporate income and profit taxes of $4 billion, other business taxes of $6 billion, and gross personal taxes of $4 billion. This leaves the deficit at half a billion.

Saving and Consumption.

Fortunately, fairly reliable information is available on the next step for investigation, the disposal of income. The observed relationships between, on the one hand, corporate savings and gross national expenditure and, on the other, personal saving and disposable income for the period from 1929 through 1940 are sufficiently stable so that they may be simply extrapolated. This is the procedure used to derive an estimate of personal saving. But it is not directly applicable to the calculation of corporate saving,

because the wide cyclical fluctuations of this quantity from negative to large positive figures show nothing about the long-term trend. A simple extrapolation of the 1929–1940 relationship would yield too low a figure for an earlier year in which the structure of the economy was smaller and too large a figure for a postwar year when corporate management will have neither the opportunity nor the incentive to retain a larger *proportion* of earnings than in previous good years.

Kuznets' recent study of national income and capital formation over the past 60 years reveals a remarkable constancy in the proportion of income saved in each decade as a whole. Hansen grants the point.[1] The ratio of gross corporate savings to gross national expenditure was about 7 per cent at the upper limit of the prewar business cycle. In accordance with Hansen's suggestion, this, applied to the assumed postwar expenditure of $132 billion, gives a figure of $9.1 billion.

It is at least reasonable to expect consumers to save an increasing proportion of income as they become wealthy, even after their expenditure is adjusted to changes in income. Therefore the relationship between personal saving and disposable income derived for the period 1929–1940 was simply extrapolated. The result indicated that personal (strictly speaking, noncorporate) saving would amount to $16.1 billion and consumer expenditures to $91.8 billion.

It would be misleading to leave out of account the temporary effects of the forced postponement of purchases during the war. Two types of evidence throw light on its probable magnitude. First, on the basis of the anticipated contraction in consumer credit that will occur, it appears that the volume of consumer credit outstanding will be some $8 billion below what would be normal under the conditions postulated for a postwar year. Second, in a good year like 1939 consumers spend over $7 billion for durable goods at prewar prices and, with gross national expenditure over $130 billion throughout the war, they might be expected to spend at least $10 billion annually. Yet it is estimated that in fiscal 1943 the supply of durables will amount to only $3 billion at 1941 prices and it will surely not rise higher for the duration.

Thus, a deficiency will accumulate at the rate of $6 to $8 billion annually. It will mount up to $15 or $20 billion if the scarcity continues for 2½ years before substantial supplies again reach the market. Some deferred expenditures are already contained,

[1] *Fiscal Policy and Business Cycles*, p. 237.

by implication, in the "normal" increase in consumer demand to $91.8 billion, which includes goods purchased on credit. But if only $8 billion of the total deficiency is spread over 5 years, the estimate for personal saving should be corrected downward by $1.5 billion to $14.6 billion per annum and that for consumer expenditure upward by the same amount to $93.3.

Investment.

So much for the disposition of income. On the basis of the estimate of consumption and the assumptions about government it appears that, with a gross national income of $132 billion, the gross savings of corporations and individuals together would amount to $23.7 billion. It will be recalled that Federal, state, and local governments are assumed to have a consolidated deficit of half a billion. Therefore, unless depression is to result, other offsetting items must be found in the amount of $23.2 billion. If there are prospects for this volume of private investment, then no deficit spending other than that assumed will be necessary to maintain a high level of economic activity.

The first and largest item is industrial equipment. Although construction never revived during the thirties, the correlation between equipment expenditures and gross national expenditure was nearly perfect and almost the same as in the twenties. The reason for the difference in behavior as between equipment purchases and construction is not difficult to explain. Structures are very highly durable and, if suitably maintained and modernized and altered from time to time, they are subject to only slow obsolescence. There is little incentive, therefore, for the construction of new plant and new commercial structures except in periods when the output of goods and services and consumers' real incomes are rising above levels previously attained. Much equipment, on the other hand, has a short useful life and almost all of it is subject to more rapid obsolescence. Therefore, purchases of equipment are far less postponable than expenditures for new construction, and their volume is bound to be more closely tied to the general level of economic activity.

Nevertheless, a reliable prediction of total equipment purchases, given gross national expenditure, cannot be made on the basis simply of the observed relationship between their magnitude and the level of economic activity. It is not easy to be sure on the basis of the close correlation between these two variables to what extent

changes in economic activity motivated the buyers of equipment and to what extent the behavior of the latter caused the changes in gross national expenditure. But an analysis of the behavior of components of the total, *i.e.*, of the equipment expenditures of each major industry separately, furnishes more reliable guidance. A given observed change in so large a component of total investment expenditure as total equipment expenditure might be cause rather than effect of an apparently associated change in the latter. But a given change in the equipment expenditures of, say, the lumber industry could not be expected to cause a change of more than three or four times the same absolute magnitude in gross national expenditure. When it turns out, therefore, that there is a close correlation between equipment expenditures in this industry and gross national expenditure, and that a given change in equipment expenditures by the lumber industry is normally associated with a change in gross national expenditure roughly one-eighth as great, it is apparent that the observed relationship between the two variables cannot be due simply to the multiplier effect.

A preliminary study of approximately 20 components of total equipment expenditure reveals that significant relationships of this type between the components on the one hand and gross national expenditure on the other exist in all but 5 cases, for most of which there is a specific explanation. It is reasonable to conclude, therefore, that capital expenditures of this type are, to a major extent, derivative from changes in the level of economic activity. To be sure, the nature of the relationships will probably be altered permanently by the war. However, an extrapolation of the experience of the last 10 years furnishes as reasonable a guess as can be made at the moment. It yields a figure of $10 billion for total expenditures on equipment, including those financed out of current expense. To be safe, the figure has been put at $10.2 billion (including 1.2 charged to current expense).

The other two components of long-term capital expenditures by business are those for nonresidential, private construction, *i.e.*, for plant. These do not show any close relationship with gross national expenditure over the past 20 years, probably for the reasons outlined above, and are therefore harder to appraise.

Two major but conflicting factors must be taken into account. On the one hand, a high figure might be expected because the production, sale, and consumption of civilian goods is assumed to be at a far higher level than has ever been achieved in the past. The

precedents of the twenties should be of greater value than those of the thirties. On the other hand, there is the war itself. Plant construction is proceeding at a prodigious rate at the present moment and an enormous volume of new plant has already been built in the past 2 years. Many of these facilities (more plant than equipment) will be convertible to peacetime uses.

Putting the evidence together, $5 billion appears to be a reasonable figure. This is only 4 per cent above the 1929 figure, although gross national expenditure is assumed to be 32 per cent higher. Also the two components would have to be $2.9 and $3.2 billion respectively, a total of over $6 billion, in order to constitute the same percentage of gross national expenditure as they averaged from 1922 through 1930.

The total of plant and equipment expenditures needs, however, to be corrected to take account of the postponement of purchases during the war. The experience of the early twenties might give rise to the expectation of a high rate of investment for a period of 4 to 6 years at least. But it is at least possible that with a more widely diffused war demand, our stock of capital goods and structures will be better maintained than it was from 1916 through 1919. There are fewer purely civilian industries in which capital can be consumed without war production being retarded.

The only elements of deferred business demand that are at all measurable are those that arise from the failure to make good depreciation and from the necessity for extensive reconversion after the war. There is no way to take account of obsolescence. First, as to depreciation, it would appear as if annual capital consumption will amount to around $2.5 billion so that, if restrictions on purchases of equipment and on construction continue for 2½ years, the backlog would amount to over $6 billion. Second, as to reconversion, it is hard to see how the total could run much above $4.5 billion and $3.5 billion might be a more reasonable figure. Of course, insofar as the new facilities are converted, the backlog of postponement replacement purchases will be made up. The two estimates should be regarded as, in part, alternatives. But since their sum is between $9.5 and $10.5 billion, it is certainly reasonable to assume that deferred private capital expenditures will add at least a billion per year for 5 years to the total investment that would normally be forthcoming with the gross national expenditure of $132 billion.

Now an estimate of "normal" plant and equipment expenditures based upon past experience contains already an element of "normal"

cyclical deferred demand because in any peacetime year of high prosperity, a backlog of demand accumulated during preceding years of lower national income is in process of being made good. Does this mean that the $5 billion backlog ($1 billion per year for 5 years) on top of the high estimate for normal demand yields too high a figure? On at least two counts, a negative answer is indicated. First, no account whatever has been taken explicitly of obsolescence during the war. Yet it will proceed at an accelerated rate. The war will leave behind it a heritage of new materials, new methods, and new products. Machinery that could have been adapted with small change to 1942 models will be junked when 1945 models are being launched. Furthermore, plants will have been completely disarranged, old machinery moved out. The temptation to replace it with new is going to be much greater because an expensive and time-consuming reconversion will be necessary anyway.

Second, the backlog contains no allowance for postponed net additions to the capital stock, only for net capital consumption. Yet, a rate of production considerably greater than that which has even yet been achieved in the war is postulated for the postwar years. It is absolutely essential to keep clearly in mind just what this means. It means that for every war plant which is retained by the government as stand-by capacity or that is located in a high-cost area and is, therefore, abandoned, a plant that has been idle during the war would have to be brought back into use or a new plant would have to be built. It means that all the special purpose machinery now being used to produce airplanes, tanks, and munitions would have to be replaced by reclaimed or new equipment designed for civilian production. It means that the railroads would face the conditions not of 1935 or 1938 but something a good deal better than 1941 (a year in which their competitors were still going strong but when gross national expenditure did not approach $132 billion). When this picture is clearly visualized, it is apparent that something does have to be added to "normal" boom expenditures in order to yield a reasonable estimate.

The last remaining major component in private capital expenditure is residential construction, which is estimated at $5.2 billion in a postwar year. The reason for the choice of such a high figure is the inherited housing shortage which will be still further exaggerated by the sharp curtailment of construction during the war. Between 1930 and 1940 a large proportion of the net increase in the number of families was matched by new construction, the remodel-

ing of single dwellings into multiple dwellings, and a decline in the number of vacancies. But there was an increase of over 1 million families in the total number housed in backs of stores, shacks, fruit sheds, tents, adobe huts, dugouts, caves, and other picturesque, but, presumably, unsatisfactory types of shelter and doubled up with others. Clearly, this was a symptom of unemployment and low income and it must be presumed that these families will swell the market for housekeeping units after the war, if employment and income is maintained.

This backlog of potential demand from the thirties is being built up still further during the war. Both the further accumulation of deferred demand and the normal or current demand that will make itself felt after the war can be calculated from the expected increase in the number of families and an estimate of the replacements required to prevent steady depreciation in the condition and quality of the stock of housing. These components indicate an annual need for nearly 800,000 nonfarm units. Taking account of actual construction during 1940 and 1941 and assuming a restricted rate of construction through the middle of 1944, the accumulated deficiency will be built up to over 2.5 million units by the earliest date at which the construction industry could again be geared to produce residential housing in large volume outside of the defense centers. Sixty per cent of this backlog (representing effective demand) spread over a 5-year period and added to the normal or current demand, indicates that a market could be found for a total of over 1 million new units annually without any increase in the vacancy rate above the 1940 level. At 1941 prices, such a building program would involve an annual expenditure of $5.2 billion. This makes no allowance whatever for an improvement in the standard of housing, for accruing obsolescence, or for the effect upon the quality of housing demanded of a high per capita income. It makes allowance for the replacement of houses (other than those destroyed or demolished) at the rate of only 1½ per cent per annum. Finally, it takes no account of the fact that much defense housing will not be useful after the war.

Two remaining sources of demand have to be looked into in order to complete the foregoing model. One is the increase in inventories. The situation in this connection is going to be decidedly curious at the end of the war. Because of the enormous volume of output, if for no other reason, the value of goods in process, which means of goods in inventory, is sure to be already large. But the major

part of goods in process in the war industries are going to be valueless for civilian purposes. Meanwhile, for reasons indicated above, stocks of civilian goods will be deeply eaten into. Therefore, it may well be that an inventory boom, such as occurred in 1919, will be set off by the removal of wartime restrictions. Heavy inventory accumulation could certainly proceed for a number of years without creating an unstable situation. On the basis of past experience a conservative assumption is that it will proceed at the rate of $1.5 billion per annum for 4 or 5 years at least. At this rate, inventories will expand just half as rapidly as they did in 1941, $0.3 billion less per year than they did in 1940, and only $0.2 billion more than in 1939.

The last source of demand requiring consideration is the export market. Unless the outcome of the war is so unfavorable that the United States will have to continue its armament program, it will certainly run a substantial export balance for some years. This will have to be accompanied by foreign lending, public or private, because there is no other way in which the rest of the world can pay for American goods. If it is, there are two directions in which our exports can flow without exercising a deflationary influence upon the rest of the world.

First, goods and funds will be needed in large volume to initiate the rehabilitation and reconstruction of Europe and the Far East. Although foreign lending for this purpose may be sound in that it will contribute to a restoration of the productivity of European nations, it is hard to see how they can assume the burden of interest charges and rapid repayment without subjecting both the debtor nations and the United States to excessive strain. A substantial part of such exports will, therefore, in all probability take the form of lease-lend assistance. Insofar as they do, the figure for Federal expenditures and the government deficit should, perhaps, be larger and that for the export balance correspondingly smaller.

Second, bona fide foreign investment may be possible in all those nations which still depend upon Europe and the United States for a part of their supplies and manufactured goods and especially of capital equipment. It must be remembered that the replacement of plant and equipment necessary to offset depreciation and obsolescence and the expansion necessary to keep up with growing population is going to be deferred during the war in Latin American countries and the British Dominions as well as in the United States. The symptoms of this deferment may already be observed in the

strict rationing of exports to the various Latin American nations and British Dominions. The experience of the years immediately following the last war give some indication of the magnitude of the export balance that is to be expected. In 1919 the net foreign balance was well in excess of $3 billion; in 1920 it exceeded $2 billion, and in 1921 it still amounted to $1.3 billion. The lowest figure that is at all realistic for the immediate postwar is $1.5 billion.

The model now, at last, begins to take shape. When allowance is made for the bulge in consumers' expenditure that reflects deferred demand and the extra billion of capital expenditures, listed as a special item, it appears that the demand which would be generated by the sale of $132 billion worth of goods and services would add up to $133.4 billion of spending. The extra $1.4 billion has to be deducted from the sum of the various components in order to make Table 1 balance. For whatever it is worth, the evidence indicates that, with economic activity maintained at a wartime level and with government budgets reduced to a modest total, consumers' expenditures and business expenditures would provide an adequate market for the whole output of the economy.

The Transition.

But it is well, too, to understand what these results do *not* prove. To begin with the more pressing matter, they do not ensure that the transition from war to peacetime production will be successfully achieved. Two dangers threaten. The first is that with an unprecedented volume of purchasing power in the hands of consumers and with strong pressure for the release of wartime controls, the demand for civilian goods will expand far faster than their supply. This spells the repetition of the postwar inflation of 1919. The second danger is a deflation of incomes that could forestall potential prosperity. The root of both difficulties is, of course, the physical impossibility of reconverting the whole American economy for civilian production overnight. There is a real possibility that there will be simultaneously a scarcity of civilian goods and extensive unemployment.

It is essential to avoid economic insecurity and the resulting deep sense of frustration just at the moment when the war is ended. The best way to handle the situation, therefore, is to use the spending power of the government generously but briefly to maintain consumers' incomes, and, at the same time, to relax only gradually wartime controls over civilian spending. There are two moves that

should be avoided at all costs. One is the initiation of a program of heavy public works. This is probably the worst way to use the spending power to meet the essentially short-run problem of the transition. It is notoriously impossible to start heavy public works without delay and it is enormously wasteful to halt them once started. Scarcely less unfortunate than a public works program would be another expansion of the WPA. Everything should be avoided that has the effect of tying members of the working force to particular localities or occupations. And Federal funds should be paid out through an agency of the government which does not have and will not acquire a vested interest in perpetuating depression policies into a boom.

The Long Run.

The problems of the long run are of a different nature. Mr. Keynes once dismissed them with the oft-quoted quip that "in the long run we will all be dead." But too little is known and too much can be inferred about this particular long run to dismiss it lightly. The second conclusion that the evidence sets forth above does *not* prove is that private investment would continue to be adequate indefinitely even if gross national expenditure remained stable at a high level. Is there any hope, then, that it will be possible to maintain reasonably full employment for more than a few years through reliance upon private investment? The question is not a simple one because the prospects for investment are inextricably tied up with the need for it; what is possible depends upon what we desire. But, without inquiring too deeply into the motives and desires of people, it is safe to say that any rational calculus points to the overwhelming social need for capital expenditures which have the effect of increasing productivity. Once this need is clearly recognized, it makes no sense to say that modern technology demands a low investment, high consumption economy, and that the great era of capital accumulation which began, say, toward the end of the eighteenth century ended in 1929. Neither a moderate present increase in private consumption nor, still less, an expansion of public services which do not increase productivity is half so pressing a need as the resumption of investment on a large scale. The United States is still a poor nation, and its income cannot grow except through true investment, public or private.

There is no need to labor the point. But its practical implication does, unfortunately, need to be emphasized. Public spending,

so long as it is carried on in what is mainly a private-enterprise system, is bound to go largely for goods that undergo no test of consumer demand. The test may not be a fair or adequate one, but when all due credit is granted, it is still true that the deliberately expanded public expenditures of depression years usually go for objects that come far down in the citizens' scales of preference and pass over those that stand near the top. One of the reasons is the pressure to avoid direct competition with private enterprise. Another is the failure of most governments in the world to balance costs against advantages in any systematic or rational fashion. But whatever the reasons, there is no place in the nation's budget for submarginal purchases. Before we can well afford any more post offices or even irrigation projects, we need the houses, factories, machines, highways, automobiles, power plants, movie theaters, restaurants, and other paraphernalia that would make possible the production of goods and the rendering of services consumers desire to the tune of at least $140, $150, $160 billions a year.

Now public spenders have an answer to this line of argument. It is that unemployment rather than a high rate of private investment is the practical alternative to high consumption and public spending. In other words, they revert to the theme that a high rate of private investment, however desirable, is not *feasible*. The process of investment, if it increases productivity, has the effect of enlarging the capacity of the economy to produce goods and services. Every burst of investment activity is bound, therefore, to end eventually with a saturation of investment opportunities unless the national income grows uninterruptedly and rapidly. And, if the *proportion* of the national income that is saved does not decline, the rate of investment must grow to absorb the expanding volume of saving. This means that national income must grow at an *increasing* rate. Such a development sounds both frightening and impossible and it would certainly be difficult to engineer.

But if this picture of a national or world economy expanding at an accelerating rate seems more like an astronomer's description of the universe than like a sober economic possibility, it is helpful to remember that it is a tolerably good representation of what happened for at least 150 years prior to 1929. If, as Kuznets suggests, a roughly constant proportion of the national income has gone to investment, it is perfectly apparent that the economy has grown at a faster rate *in absolute terms* (a more nearly constant percentage rate) in each successive decade until the thirties. There is

nothing inherently impossible about a steadily rising absolute rate of growth or even about a rising percentage rate of growth.

Indeed, there is one special reason for believing that circumstances are favorable to the reestablishment of a high rate of growth of existing industries, even if new major products such as the automobile do not appear. It may most easily be made clear by confronting the threat of inadequate investment opportunity with the other great economic threat of our times, technological unemployment. Throughout the whole of the last 20 years, the rate of increase of productivity of labor has been unprecedented. It was scarcely interrupted even by the great depression. The only way in which the fruits of this process can be gathered in the form of higher incomes rather than technological unemployment (as all economists are aware) is by an increase in the over all output of goods and services so rapid that it will absorb both the increase in the population and the increase in output per man. Yet, such a rate of growth of the output of the economy would, as just pointed out, call for a high rate of investment. Furthermore, it would "call for" it in the sense of rendering it profitable as the current war boom indicates.

This does not imply for one moment that the problem can be left to work itself out without conscious control or direction. The *potentialities* for a rapid growth in wealth and income made possible by private investment do exist. But there is no certainty that a rate of growth sufficient to make a high rate of investment profitable in the long run will be *spontaneously achieved* after the war. Nor is it realistic to hope that the process of growth would not be interrupted in the future as it has repeatedly been in the past and that such interruptions, left to themselves, might not again degenerate into states of chronic stagnation. Growth through private activities is wholly impossible unless there exists in the business community a deep-rooted expectation of continued growth. Interruptions in the process breed depressions and these, in turn, if they last long enough, undermine and temporarily destroy the expectation of further growth. Because the process is dynamic and because it feeds on itself, a rapidly growing high investment economy is inherently unstable. It must be granted that the necessity is bound to arise periodically of providing a stimulus and this will have to be done by public authority. The point is not that a private enterprise economy can run itself, but, rather, that proper management might succeed in maintaining a high secular rate of

growth and, consequently, a high rate of private investment. This is the proper objective for policy for decades to come.

Two Rules of Policy.

With this preface two general rules may be suggested that should govern all public policy insofar as it is designed to control the general level of economic activity. The first is that fiscal policy, taxation policy, the policies of local, state and Federal regulatory agencies, the powers of the antitrust division, the activities of public enterprises (such as the TVA, municipal power plants and water systems, state highway departments), and even the sacred and untouchable activities of the Federal government toward labor relations and agricultural subsidies should be designed to create conditions favorable to enterprise and investment and thus to minimize the need for deficit spending by government.

The second general rule is that when direct stimulants are applied to the economy, they should encourage the use of resources in the most productive fashion. Future deficit spending should take the form either of direct outlays for the creation of productive assets and for raising productivity or else of direct subsidies to private investment.

The first heading covers what used to be called liquidating public works, highway construction, services (especially medical care, public health, and vocational training) which serve directly to increase productivity, and even conservation activities, providing, however, that some effort is made to compare their cost with the ultimate increase in output they are expected to make possible. The method of direct subsidies is even more promising, though it has not been used on a large scale since the days when it played so large a part in the building up of the American railroad system. Such a policy has a great deal to recommend it. Every dollar added to the Federal budget should result in an increment of at least $3 or $4 of capital expenditure. A minimum of public administrative machinery would be required; subsidies might well be related to tax policy. And it would have the supreme advantage of stimulating those sorts of capital expenditures which, if expectations turn out well, would raise productivity and promote an increase in the output of the things consumers wish to buy. Under both headings, the wide opportunity for mixed public and private investment should be mentioned.

Finally, if all efforts to promote private investment fail, very serious consideration should be given to the possibility of socializing a sufficient part of the economy so that the government could, without competing with private industry and without frittering away its funds on leaf raking, maintain through its own direct action a high rate of productive investment.

PART II

The State of Capitalism

Chapter VI

CAPITALISM IN THE POSTWAR WORLD

Joseph A. Schumpeter

I

For the purposes of this essay capitalism will be defined by three features of industrial society: private ownership of the physical means of production; private profits and private responsibility for losses; and the creation of means of payments—banknotes or deposits—by private banks. The first two features suffice to define private enterprise. But no concept of capitalism can be satisfactory without including the set of typically capitalistic phenomena covered by the third. Where it is absent we might speak of commercial society. By socialism we shall mean an institutional arrangement that vests the management of the productive process with some public authority.[1]

In trying to forecast the role, if any, that capitalism in the sense defined may be expected to play in the postwar world it is well to remember that its fate is not a question of the merits or demerits we may individually see in it. Our judgment about these is a matter of personal or groupwise preference that depends on interests and ideals largely determined by our personal or groupwise location in the social organism. What we mean when we say that we are for or against capitalism is that we like or dislike a certain civilization or scheme of life which is historically associated with the three economic features mentioned. But civilizations are incommensurable. Even if we agreed to neglect those cultural aspects which are what really matters to us, and to make the "desirability" of retaining or eliminating capitalism turn on some purely economic

[1] It should be noted that this definition of socialism is not only purely economic but also purely formal. It says nothing about the structure and character of a socialist society, *e.g.*, whether it is equalitarian or not, warlike or pacific, democratic or authoritarian. Friends and foes of socialism are in the habit of endowing their concept of it with additional traits and hence in general mean by it something much more specific.

criterion—such as comparative productive efficiency—we should never agree about the result. For even if those extraeconomic and largely extrarational preferences did not prevent us from admitting that any criterion could ever tell against the alternative we have chosen to espouse—which they no doubt would in most cases—we should immediately challenge a criterion that did. No amount of honest intention to place oneself on the standpoint of the public welfare or of the nation's interest avails against that. For the point is precisely that these words carry different meanings for different minds. The only thing we can do in something like a scientific frame of mind is therefore to try to visualize, irrespective of our wishes, the actual situations which may be expected to emerge and the relative power of the groups which will be in a position to assert their interests and ideals in handling those situations.

Another point should be borne in mind. No social system is ever pure either in its economic or in its political aspects. As regards the former, structural principles, such as, in the case of commercial society, private management of the process of production and free contracting, are never fully carried to their logical consequences. People were at no time allowed to do with their own quite as they pleased, and society at all times limited the range within which they might freely contract. In the epoch of intact capitalism, law, custom, public opinion, and public administration enforced a certain amount of public planning, while in a society that had adopted the structural principles of socialism there was such a thing as Lenin's New Economic Policy that left room for a certain amount of *laissez faire*. It follows that, public management or planning being never either absent or complete, our question concerning the immediate future should not be couched in terms of "capitalism or socialism": there is a great variety of intermediate possibilities.

Still more important for social diagnosis and prognosis is, as we shall presently see, the fact that no society is ever homogeneous. By this I do not merely mean that the political sector of every society grows out of, and hence reflects, all the different interests and attitudes of the various groups and classes that the prevailing social system produces. I mean something much more fundamental: every society contains, at any given time, elements that are the products of different social systems. Thus, feudal society harbored, besides the lords and peasants and artisans that constituted the essential elements of its system, also other elements—traders, for instance, and certain classes of producers—that did not belong

to the feudal organism and dwelt in towns which that organism failed to subjugate or to assimilate. In the capitalist epoch, the classes that are the products of the capitalist process are hardly ever found alone. Practically always they exist in symbiosis with an aristocracy and a peasantry of noncapitalist origin. And this fact is not only, as one might think, responsible for frictions and other secondary phenomena. It is of the essence of the social process. A purely capitalist society—consisting of nothing but entrepreneurs, capitalists, and proletarian workmen—would work in ways completely different from those we observe historically, *if indeed it could exist at all.*[1]

II

Both in its international and in its domestic aspects, capitalist economy is adapted to the requirements and habits of a normally pacific world. "Total war" under modern conditions calls for a concentration of effort much more stringent than the mechanism of capitalist markets can achieve. Wartime planning by government in fact suspends the normal operation of capitalist processes. In doing so it develops, on the one hand, economic structures and situations and, on the other hand, new social organs and positions of power which do not automatically disappear with the emergency that brought them into existence. They have to be liquidated, if at all, by a series of distinct measures which naturally meet resistance. We have seen that the outcome of the ensuing struggle will not depend on any abstract desirability of a return to prewar ways but on the political forces marshaled for and against it.

The strength of these forces in turn will depend, first, on the duration of the war in question and, second, on the vitality of the capitalist system independently of the war. Thus, in 1919, the United States emerged from a spell of wartime planning that had been both mild and short. The various war boards and their bureaucracies had not had time to get into full working order, let alone to settle into positions which they would have looked upon as permanent. The business world and the public in general had not had the time to get accustomed to their rule and to accept them as

[1] Many readers will feel that while this might apply to European and Asiatic countries, it could not possibly apply to the United States. But it would be easy to enumerate the very particular conditions—now rapidly passing—which explain why a purely bourgeois regime was in this case able to hold its own for so considerable a time.

parts of the normal scheme of things. Moreover, all the groups that counted politically were fully determined to stand for private enterprise and in fact did not clearly perceive an alternative—which fact indicates precisely that the vitality of American capitalist society then was not yet substantially impaired.

This historical instance should not blind us to the possibility that events such as total war may influence social evolution more profoundly than words like "catastrophe" and "conflagration" imply. They may create situations so compelling as to impose permanent departures from the lines previously followed, and attitudes greatly at variance with any observed before. They may change the distribution of political power in unpredictable ways. The bolshevist regime is obviously of more than passing importance; yet it could never have established itself without the First World War and the largely accidental ways in which that war affected Russia. We may indeed succeed in interpreting the break as the result of existing tendencies that were merely accelerated by the war, and thus formally salvage historical determinism as a philosophy. But this does not increase its value as a working hypothesis.

There cannot be any doubt but that, in all countries concerned, the present war effort will put existing social structures under severe strain which may result in breakdown or fundamental transformation. The chances for this to happen are presumably greater in vanquished countries, but the victor countries are by no means exempt from this possibility. All the more important is it to raise the question of what we may term the tensile strength of the social systems that are being exposed to that strain.

It is a commonplace that capitalist society is, and for some time has been, in a state of decay. But there is no agreement about the precise nature of that decay. Differences of opinion on this point can be conveniently described in terms of two theories.

There is, first, the familiar theory of Vanishing Investment Opportunity.[1] It starts from an undeniable truth, more or less explicit recognition of which constitutes its chief merit. Unlike other economic systems, the capitalist system is geared to incessant economic change. Its very nature implies recurrent industrial revolutions which are the main sources of the profit and interest incomes of entrepreneurs and capitalists and supply the main

[1] The outstanding exponent of this theory is Prof. Alvin H. Hansen; see, *e.g.*, his *Fiscal Policy and Business Cycles* (New York, 1941), Ch. I, and his essay in this volume.

opportunities for new investments—such as railroad building or the construction of electric-power plants—and the main outlets for new savings. Whereas a stationary feudal economy would still be a feudal economy, and a stationary socialist economy would still be a socialist economy, stationary capitalism is a contradiction in terms. This becomes evident when we survey its most characteristic types, processes, and institutions, all of which would become atrophic in a stationary world.

Now the theory in question holds that this is happening in our day. That process of economic conquest is exhausting its possibilities. No very great innovations are in prospect, and those minor ones that may be said to be in the offing fail to stimulate entrepreneurship and investment either because they are capital-saving rather than capital-consuming or else because they are more suited to public than to private management. Moreover the great impetus given to investment in the nineteenth century by the opportunity of opening up new countries and sources of raw materials has spent itself. Finally the falling birth rate and the consequent slackening of the rate of increase in population tend to dry up a source of particularly calculable investments. For all these reasons the saving-investment process, which is of obviously vital importance to capitalist society, works with increasing friction. Thrift, instead of being the means of expanding the industrial equipment becomes a cause of falling prices and of unemployment. Hence the necessity of injecting into an anemic system new purchasing power: the first and foremost application of this theory was in fact to provide a rationale for the fiscal policies of the past decade. Hence also—so we may continue for our purpose—progressive paralysis of the political organs of capitalist society and reduced ability to withstand shocks or to defend itself against attack.

This theory cannot be adequately discussed here.[1] It must suffice to state that there does not seem to be any good reason for believing that, except as a temporary effect of the world crisis, the opportunity for great innovations in the economic process has been exhausted; that the tendency of innovations to become capital saving to the required extent has been illustrated by examples but has not been established convincingly; that the opening up of new countries, even if we assume it to be completed, was but one of many opportunities and might be replaced by others—in fact has

[1] I refer the reader to the discussion in my *Business Cycles* (New York, 1939), Vol. II, Ch. XV.

been replaced by others during the twenties; that the falling birth rate, both through its direct effects on demand and through its indirect effects on motivation, may become economically significant in the future but that it could hardly be used in an explanation of the course of events in the thirties, even if the relation between the rate of increase in population and economic progress were less complex than it actually is.

The theory of vanishing investment opportunity obviously invokes the factors mentioned in order to deduce from them a state of perennial inadequacy of profit expectations or, to use Lord Keynes's term, of the marginal efficiency of capital. It is only by this effect on profit expectations that those factors can be held to account for insufficient investment and, in turn, for underemployment. But, surely, if profit expectations are the operative link in the deduction, it is natural to stress another element the reality of which cannot be called into question and which acted on profit expectations much more obviously, *viz.*, the anticapitalist policies adopted, in most European countries, ever since the First World War and, in the United States, since 1933. The fact that both in Europe and in the United States the capitalist process displayed unmistakable symptoms of strain exactly since the break in the legislative and administrative attitudes of public authority occurred may be significant. This element constitutes the pivot of the other theory.[1] It also starts from the proposition that capitalism is essentially a process of economic change and then goes on as follows.

One of the most familiar phenomena of that process of change, the full importance of which was first recognized by Karl Marx, is the emergence of large-scale business, which to some extent tends to compete out of existence—or, to use the Marxian phrase, to "expropriate"—small or medium-sized firms. It stands to reason that, especially under conditions of democratic politics, this process weakens the political position of the industrial bourgeoisie, for a numerous stratum of businessmen owning and managing small or medium-sized firms is obviously much less exposed to political attack and in a much better position to withstand it than is a small number of salaried executives and large shareholders,[2] *quite irrespec-*

[1] I have developed it at length in my *Capitalism, Socialism, and Democracy* (1942), Part II.

[2] Here, any adequate exposition of that theory would have to digress into political sociology in order to show that the behavior of a society toward a particular interest is primarily determined by the inducement and the opportu-

tive of comparative economic performance or "service." Moreover, within the big concern the pungent sense of property and the will to fight for it tooth and nail withers away: the big concern thus not only "expropriates" some of its competitors but also its own capitalist interest. Those executives and shareholders are not only in a less favorable position to defend their ground than were the owner-managers of old but they meet attack in a much weaker spirit. Big business is in fact but a midway house on the road toward socialism.

The capitalist process undermines the structure of capitalist society in many other ways. I shall mention two only. First, it tends to destroy, economically or socially, the position of what may be termed the protective strata. The rise of the bourgeoisie ousted from political leadership the old aristocracies who knew so much better how to rule than does the businessman. The factory destroyed the old crafts and the department or chain store destroys the small traders who counted at the polls. It also reduced, relatively at least, the number of farmers and peasants. And so on. Second, capitalist civilization is a rationalist civilization. It tends to eliminate extra- or hyperrational sanctions and habits of mind without which no society can exist.

Though the argument cannot be adequately developed, it should be clear that we have now before us the elements of a more realistic substitute for, or of a more realistic version of, the theory of vanishing investment opportunity and of the decay of capitalist society. The capitalist process itself produces, as effectively as it produces motorcars or refrigerators, a distribution of political power, an attitude of the public mind, and an orientation of the political sector that are at variance with its own law of life. It produces anti-capitalist policies, *i.e.*, policies that, regardless of individual intentions, prevent it from functioning according to its logic, the implications of which increasingly meet moral disapproval. Modern principles of taxation, although only one among many manifestations of the disintegration of capitalist society, afford perhaps the most telling illustration.

It is a nice question, on which it is much easier to differ than to agree, how far this decay has gone in any given case. Some symp-

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nity for attacking it and only to a minor degree by what the observer according to his own standards may consider justifiable reasons for approving or disapproving of it. These reasons, so far as produced by political or intellectual agents, are simply rationalizations in the psychological sense.

toms showed in Europe before the First World War, but without it the majority of observers might have taken a long time in becoming aware of them. In the United States, the first unmistakable symptom of decay was perhaps the lack of spirit displayed by the bourgeoisie toward the end of the world crisis when the modal business-man proved that he was no longer up to the tests imposed by his own order of things. That the decay of capitalist society is very far advanced by now—everywhere—is not open to doubt. However much we may approve of some or all of the policies of the New Deal, we cannot fail to be struck by the absence of any serious resistance to them. A bourgeois society that meekly accepts the vast transfer of wealth accomplished in the United States during the thirties—I am not speaking of war taxation—thereby testifies to its readiness to surrender, though it may not be ready to surrender to every type of conqueror. It is in such conditions that events like world wars may acquire an importance in shaping the history of institutional patterns which they could never acquire if they impinged on an intact social system.

III

We are now in a position to form an idea about the various possibilities concerning the capitalist order's survival in the postwar world. It is first necessary to visualize the economic and political situation that will confront the dominant political groups at the end of the war. In what follows we shall confine ourselves to the United States and consider no other case but that of complete victory.

Everybody is afraid of a postwar slump, threatening from a drastic reduction of military expenditure financed by inflationary methods as well as from mere reorientation of production. The all but general opinion seems to be that capitalist methods will be unequal to the task of reconstruction. This opinion in itself will be a political factor of first-rate importance. All the more essential is it to understand its rationale.

Viewed as a purely economic problem, that task might well turn out to be much easier than most people believe. It may happen that peace will be preceded by a period of decreasing military expenditure and of gradually increasing production for civilian consumption and also that the former will continue, though at a reduced rate, on a level much beyond that of prewar times. Either or both of these possibilities would greatly facilitate transition.

But in any case, the wants of impoverished households will be so urgent and so calculable that any postwar slump that may be unavoidable would speedily give way to a reconstruction boom. Capitalist methods have proved equal to much more difficult tasks.

Nevertheless the opinion that the capitalist solution of the problem will prove unworkable or, at all events, unsatisfactory, may well be true. For, like any other system, capitalism cannot be expected to function efficiently except on its own terms, that is to say, in a social atmosphere that accepts its responsibilities and incentives and allows it sufficient freedom of action. As we have seen, however, such an atmosphere and the corresponding attitude of public authority have not existed for some time, do not exist now, and are obviously unlikely to exist in future. Capitalist management would hence have to solve the problems of reconstruction at home and abroad in the face of public antagonism, under burdens which eliminate capitalist motivation and make it impossible to accumulate venture capital, with risks of borrowing greatly increased,[1] without authority in the plant, and under the close control of a hostile bureaucracy. Deadlock so complete as to practically impose socialism as the only alternative is not inconceivable, but even conditions far removed from deadlock may preclude performance comparable to that of the past.

To be sure, a temporary revulsion of public sentiment in favor of *laissez faire* is not unthinkable. I need hardly stay however in order to show how very improbable it is. The public mind has renounced allegiance to the capitalist scheme of values. Private wealth is under a moral ban. All those bars to the effective functioning of capitalism embody what to most of us are cherished achievements. In particular, reduction of the fiscal burdens imposed upon the high income brackets and upon large-scale business and removal of administrative fetters would be highly unpopular and could hardly be carried to the requisite extent in a situation in which high rates of taxes on all incomes will continue to be necessary. Intellectuals and organized labor will emerge from the war in a radical frame of mind. Nobody will dare and, what is more, nobody will care to advocate what would have to be a return not only to prewar conditions but—substantially—to the conditions of 1929.

[1] High or highly progressive taxation of profits increases the risks of borrowing for purposes of long-run investment, because it absorbs profits the accumulation of which might be counted on to take care of subsequent losses.

Nor will there be a motive for any of the political groups of significant importance to influence the public mind in a procapitalist direction. Any regime that may be established will have to court the farm group and to present attractive schemes of agricultural "planning." Farmers therefore might not be actively hostile to partial reversal of anticapitalist policies—especially if their views about railroads were taken account of—but they will see little reason why they should go out of their way for the sake of it. Organized labor will find it impossible to abandon any of the positions it has conquered even if some labor leaders should entertain doubts as to their economic value. The strata of small and medium-sized business still constitute a factor which no regime can afford to neglect. But they can be satisfied without making any concessions to big business which embodies the achievements and the vital energies of the American economy.

Thus there is a reasonable chance that the bureaucratic apparatus of the Federal administration will hold its own. At the end of the war it will first of all be in possession. It will have outgrown initial difficulties and be in something like working order. It will have consolidated its position and have acquired enormous power. It will be a factor in its own right and stand ready to deal with the postwar emergency as it dealt with the war emergency. Political forces strong enough to liquidate the organs of the war economy as they were liquidated in 1919 are not in sight. There seems to be no reason why these organs should not succeed in establishing themselves as permanent institutions, especially as they will be in a position to serve the immediate interests of agriculture and of labor and hence derive support from these quarters. In this case a sort of *classe dirigente* may develop.

The nature, structure, and ideology of this managing class is not determined as yet. Many mutually exclusive possibilities exist both as to what it will eventually turn out to be and as to what it will eventually do. Disregarding all other aspects and placing ourselves on a purely economic standpoint, we may, however, out of a mash in full process of fermentation, select a few typical possibilities each of which corresponds to the views and interests of some existing subgroup.

1. The most obvious possibility is that the economic principles of the period immediately preceding the war will be applied to postwar problems—being consolidated and developed, revised and extended, according to circumstances. In this case the policy of

income-generating public expenditure would be continued, first in order to prevent or mitigate the postwar slump and after that as a permanent device for regulating the pulse of the nation's economic life. As the reader knows, this policy commands widespread support. The fear of the postwar slump may well silence such opposition as may be said to exist. And groups with completely different ultimate aims may agree on it because it is the easiest way toward all of them and carries the further advantage that none of them need be mentioned in advocating it.

Theorists are in the habit of dealing with this policy in the abstract. But its nature and consequences depend upon the complementary policies with which it is linked. In the case under discussion, these are taxation high enough and progressive enough to prevent private accumulation and in consequence the possibility that large-scale business should ever again, financially speaking, stand on its own feet and become independent of government; labor legislation that shifts questions of wages, hours, and factory discipline to the political sphere; and strict regulation, enforced by the threat of prompt prosecution, of the behavior of big business in every respect. Under these conditions, public income generation will automatically become permanent, quite irrespective of the factors stressed by the theories framed to prove its necessity from causes inherent in the saving-investment process of capitalist society.

Such a system will no doubt still be called capitalism. But it is capitalism in the oxygen tent—kept alive by artificial devices and paralyzed in all those functions that produced the successes of the past. The question why it should be kept alive at all is therefore bound to be put before long. Such concessions about relief from war rates of taxation and so on as are within practical politics, may temporarily change details of the picture and postpone the putting of that question, but cannot be expected to change essentials.

2. It will therefore be perfectly natural—in fact it may be a practical necessity—to take further steps toward state management.

To begin with, it is difficult to see what role will be left for nonpublic banking and finance in an economic world thoroughly dependent on government financing that is itself entirely independent of private voluntary saving. Government, to be sure, still goes through the motions of "borrowing" and "lending," pays and receives interest and so on. But the life has gone out of these forms and an administrative rationalization of what is actu-

ally being done could easily eliminate them. If we assume that capitalist methods will disappear gradually there will be a narrowing sphere of activity for banks as we know them also in the future. They may continue to keep accounts and to fill administrative functions for an indefinite time. But though this may facilitate transitions it does not alter the fact that, if we must stick to old words, government will develop into the sole banker.

Again, government spending as a permanent policy cannot fail to develop into governmental planning of investment. In fact, its failure to do so would be quite uneconomical. If government expenditure is to be the pivot of the economic process it stands to reason that the productive efforts propelled by that expenditure will in the end have to be directed by public authority. The government will from time to time have to proclaim a national goal which its expenditure is to serve—such as housing for the masses, completion of the electrification of the household, reorganization of the transport system and of urban life to make them fit the conditions created by the airplane—and to define the ways in which and the extent to which each particular goal is to be approached.

There is still another reason for this. Whatever the outcome of the war, the postwar world will hardly be a place for privately controlled trade and industrial venture. As to the first, it is not easy to see how private enterprise could cope with the conditions created by the immense differences as between countries in monetary and real cost of production that have developed of late.[1] From a purely commercial standpoint, and taking account of all the "rigidities" that will prevent adaptation, the United States might well be unable to export at all.[2] Quite apart from the political considerations that are bound to complicate the problem still further, international trade in commodities and services will have to be cut off from its old background of commercial calculation and have to be managed by political treatics, bilateral and multilateral. But this implies domestic public management just as the latter implies the public management of international economic relations.

As to the second, international industrial venture involving long-term investment, the need for government leadership, per-

[1] This position is not inconsistent, however, with the theory of comparative costs.

[2] The roots of this difficulty are in the prewar situation. One of the most curious contradictions in New Deal policy was its attempt to "liberalize" foreign trade while erecting a rigid economic structure at home.

haps on lend-lease lines, in an expansion that will inevitably carry imperialist features, is still more obvious. The spacious possibilities that open up under these heads should be noted not less than the sources such a system harbors of waste surpassing anything ever charged to the account of capitalism. It should also be noted that such a system leaves the managing bureaucracy free to allocate to private business as much or as little room as may be desired. Just as the TVA, a national venture, let contracts to private firms, so a similar national venture on the Yangtze, though initiated by government and controlled by it, may parcel out individual jobs to capitalist firms. Therefore, on the understanding that the essence of the bourgeois economy will be absent from the picture, we may call this system Guided Capitalism.

3. Some measures of nationalization will almost inevitably suggest themselves in a system of the type just discussed. Moreover, other measures—perhaps the nationalization or municipalization of utilities, of insurance, of mines—will be rendered easy by public support. It is difficult to foretell how far this tendency will go. The term "nationalization" does not sound well to every ear and it may be that other means of establishing no less complete public control, even if less rational and fraught with more friction, will be preferred by the political groups in power. But if the Federal government should follow this line to a significant extent, and if it should try to run the nationalized industries according to the principles of business rationality, Guided Capitalism would shade off into State Capitalism, a system that may be characterized by the following features: government ownership and management of selected industrial positions; complete control of government in the labor and capital market; government initiative in domestic and foreign enterprise.

4. It will always be a matter of taste whether a given way of running the economic engine be called socialist or not. On the one hand, disgruntled bourgeois spoke of socialism when the first municipal gas works and the first progressive income taxes put in appearance; on the other hand, socialist groups that are not "in on it" will never admit that anything not sanctified by Marxian doctrine can possibly be genuine socialism. Moreover, people care so much more for words than they do for things, that acceptance or avoidance of the term socialism may be dictated by tactical considerations. In this country, these considerations seem to tell against rather than for it so long as no violent break is on the cards.

If, however, we agree that advance on any of the lines we have briefly surveyed comes within the definition of gradual socialization, the problem narrows down considerably. Any approach to socialism other than by continued extension of government control and expropriation of the upper strata by taxation would no doubt meet resistance from the farm interest and from small and medium-sized business. Neither would put up a life-and-death fight in order to prevent the nationalization of big business—say, the corporations owning assets amounting to $50 million or more. But they presumably would fight against anything much more radical than this, particularly against anything which they recognized as a "revolution." Barring such a revolution which, while never impossible, cannot be expected to be successful, an amphibial state for the calculable future is certainly the most probable one. From a purely economic standpoint this may be regrettable. Such a state will suffer from a lot of frictions and inefficiencies that a return to the capitalist alternative or a resolute adoption of the socialist one would save, and it will not command the full motive power of either. On the other hand, amphibial states conserve many human values that would perish in others. Thus there may be as little reason for the fears of some as there is for the hopes of others.

Chapter VII

ECONOMIC LIBERALISM IN THE POSTWAR WORLD

Abba P. Lerner

There will be no Economic Liberalism in the postwar world unless the democracies achieve a complete victory over the Fascist powers. For the all-out effort which alone can win this victory, it will be necessary to eliminate from power those antidemocratic elements in the democracies which gave the fascists the opportunity for their crusade against every kind of liberalism in the whole world. Consequently, to assume that those who wish to establish a regime of Economic Liberalism will be in a position to do so after this war is not much more difficult than merely to assume that they will not all be dead or in concentration camps. In this essay I shall consider a program for victorious believers in Economic Liberalism.

First, it must be emphasized that Economic Liberalism does not now mean *laissez faire*. *Laissez faire* is only a means for the achievement of the ends of Economic Liberalism. It works only in special circumstances and does not always deliver the goods.

Economic Liberalism aims, by setting up the appropriate institutions, to maximize the freedom of each individual member of society to satisfy his own desires wherever this does not interfere with the freedom of other individuals.

Wherever a policy of *laissez faire*, with the government keeping its hands off all business and industry and merely protecting property and enforcing contracts, results in the establishment of perfect competition throughout the economy, then *laissez faire* establishes Economic Liberalism. The price of every article of consumption is then equal to its marginal cost, and this measures the value of the alternative article that might have been produced with the same resources. Every purchaser can choose whatever is more satisfactory to him, and its production in the place of the alternative makes no difference to what is available for other purchasers. The

reward for every kind of effort being equal to its marginal product, all efforts are directed to where their products are greatest (so that there is the greatest possible efficiency in the allocation of the instruments of production to the different possible products), and each kind of effort is exerted to exactly the right degree (thus avoiding the social waste of too great an application, which would mean that the product is not worth the effort, or too small an application, which would mean that a potential product, of greater value than the effort needed, fails to be produced).

The maximization of this freedom is not achieved simply by *passivity* on the part of the government. (Something like this, however, came to be believed by the most ardent advocates of *laissez faire*, because at the beginning of the capitalist era the most important problem facing the economic liberal was to show that the economy could work without the state regulating every departure from the feudal way of life.) The individual must be free to do whatever does not affect others, but the maximization of individual freedom involves the hindering of those whose action *does* interfere too much with the freedom of others. This is the first lesson of a war forced upon the world because of too great a freedom being given to aggressors, and the principle that positive action must be taken consciously to maximize the freedom of all is just as applicable in the economic as in the political sphere and for exactly the same reasons. With income from inherited property sufficiently checked by income and inheritance taxes to make equality of opportunity really effective, freedom of entry for all into every walk of life would permit competition to equalize earning powers (and the marginal productivity of different kinds of labor) and thus to prevent economic inequality from nullifying the political equality that is essential to every kind of liberalism.

Unfortunately *laissez faire* does not always result in perfect competition. The most efficient use of resources (from the point of view of society) and the appropriate price relationships that permit each individual to choose between different goods without affecting other individuals only come about if the output of the firms is not affected by considerations of the power of the firm, by varying the extent of its activities, to affect the prices at which it buys or sells. This power, which does not exist at all in the case of perfect competition, may arise because the market is small or because, for technical reasons, the firm has to be large, or because firms combine for the express purpose of acquiring power over prices.

In all these cases the objectives of Economic Liberalism cannot be obtained by *laissez faire* but only by positive action on the part of the government to establish the conditions where firms cannot influence price. Where the departure from perfect competition is entirely due to the combination of firms for the purpose of restricting output in order to raise the prices received for the product (or to lower the prices paid for the materials or other factors of production), it may be sometimes sufficient for the government to take legal action against such combinations in restraint of trade. But in most cases this is cumbersome and inadequate.

The appropriate remedy is for the government to destroy the power of firms to influence prices. This can be done by a very simple process which may be called *counterspeculation*.[1] Where this elimination of monopolistic restriction forced a loss on the producers, the state would have to cover it in order to permit production to continue.[2] The result of such procedure would be that if a private enterprise, paying the same prices for the factors of production as the competing government enterprise, can produce more efficiently than the government, it will be able to survive

[1] Government agencies estimate the equilibrium prices of staple goods at which the supply would be equal to the demand if everybody took prices as given. This price is then guaranteed by the government to such buyers as might be restricting their purchases to keep price down, or to such sellers as might be restricting their output in order to keep the price up. No firm could hope to compete with the government's financial resources, so that any attempt to influence price would be abandoned. If the resulting market price was not equal to the price guaranteed by the government (because of inevitable errors in the estimate of the equilibrium price) the difference would have to be paid out of (or be put into) a government fund for that purpose.

[2] Every firm will produce up to the point where the price is equal to the marginal cost, just as in perfect competition, but now the price will be less than the average cost in all industries where there is a natural monopoly. Indeed it is this technical condition that makes it a natural monopoly. The low marginal cost would result in "cutthroat competition" and would bankrupt all the firms, so that it is only under a monopoly that the service can continue to be provided in a capitalistic economy. The ends of Economic Liberalism can be achieved in all such cases by the state covering the loss forced on the producers by the elimination (through counterspeculation) of monopolistic restriction. The government could provide the service itself, charging the public the marginal cost for the product. To give private enterprise an equal chance, so that it should prevail wherever it happens to be more efficient than government enterprise, the government could subsidize private production by a grant toward the installation and renewal of plant equal to the deficiency of the marginal cost (which will be equal to the guaranteed market price of the product) below the average cost in the most efficient government plant.

government competition, and where private enterprise is less efficient than government enterprise it will have to give way to the latter.

This pragmatic decision between private and government enterprise in each case according to its social merits cuts right across the false issue between capitalism and collectivism. While collectivists thought to complete the democracy that was started by capitalism by removing the economic inequalities that accompanied private ownership in the means of production, and capitalists thought to defend not only their privileges but the democratic gains of capitalism by resisting all departures from *laissez faire* (except those, like tariffs, which were pressed for by sectional interests), the fascist revolt against all democracy threatened to destroy both. For a long time the collectivists (and some capitalists who were blinded by fear of the Reds) saw in Fascism nothing but the capitalists defending their property from democratic collectivism, and the capitalists (and a few collectivists blinded by a deification of planning) saw in fascism nothing but the natural state of a collectivist society. By the time the war is over the lesson will have been learned that the issue of capitalism versus collectivism was a minor or even a false issue; that neither private nor government enterprise must have a monopoly if the democratic ideals of Economic Liberalism are to prevail; but that both must be permitted to contribute to the general welfare, each surviving in the fields where it proves itself superior and both providing an important guaranty of the freedom of the citizen by competing with each other in demanding his labor and in providing him with the goods and services that he purchases.

Another important lesson that will have to be learned by the time the war is over is that the most economical way, as well as the most just way, of overcoming opposition to policies that have to be undertaken in the public interest is to provide generous compensation for all who have to make a special sacrifice. The resistance to this is closely related to the strong feeling against permitting anyone making money out of the war (as if that were somehow more wicked than getting rich in peacetime). This feeling comes from a failure to distinguish between one who makes money by instigating war or by impeding the war effort and one who does his best to produce what is needed and in so doing makes large profits. A manufacturer of war materials who makes millions by applying himself to discovering ways of saving materials and

labor is doing a great service to his country. He can be made to give up some of his claim on society, if that is considered to be excessive, by taxes on income, on profits, and perhaps even on capital, but to call him a profiteer and not to let him get *any* of the gain from such economies only results in discouraging him from making them and the national effort thereby loses. Patriotism is not enough. If it were enough to induce everybody to make his maximum effort in the social interest, we could immediately abolish private property and move directly into the last idyllic stage of communism. Very few people believe this to be practical if applied throughout the economy. It is even less practical to apply it in times of great emergency to the most vital centers of our effort, where the patriotism of the key men would be subjected to the additional strain of observing the quiet enjoyment of fortunes by men who had made their money out of producing less important peacetime goods.

This principle of adequate rewards and compensations will be as useful after the war as in prosecuting it, especially in the course of elimination of the antiliberal economic barriers to trade. The benefit to society from the abolition of these barriers is greater than the loss of the vested interests built up behind them, so that complete compensation to the vested interests would still leave a net gain to the citizens who will have to make the payment; but if the existing prejudice against compensation continues, it is likely that the restrictions will stay and the greater evil of the restrictions will be kept in place out of too great a concern for the smaller evil of a compensation being received by people who do not fully merit it. Behind the objection to large compensations, apart from simple fallacies about the country not being able to afford them, lies the feeling that the existing distribution of wealth is somehow more defensible than the distribution of wealth after the compensatory payments have been made. This has only to be stated explicitly for it to be seen that a real benefit to society should not be shelved because it will cause a switch in the distribution of an increased national wealth.

The most impressive obstacle to Economic Liberalism in the postwar world is the need for a formula which will be satisfactory to both the U. S. A. and the U. S. S. R. One important step in this direction is the pragmatic resolution of the issue between private and collective enterprise as merely a matter of relative efficiency, with both given complete legitimacy, and every country free to

If a country disregards the foreign value of its currency and increases effective demand at home (to the level which gives it full employment), the increased demand for imports by the newly employed will cause the country's currency to depreciate to the point where the higher prices of imports and exports (in the depreciated domestic currency) have sufficiently discouraged imports and encouraged exports to make them equal to each other again. There is no export balance and the other countries are not harmed. The depreciated exchange is not the *cause* of an increase of employment at the expense of the other countries but a *result* of an increase in economic activity that does not affect the other countries. If all countries completely disregard the effect on their foreign exchanges and create enough effective demand in their domestic markets to give full employment at home, they will all gain in employment, there will be no general depreciation of the exchanges (which by definition is impossible), and international trade will not be hampered in any way.

When full employment has been achieved all round, it will not be possible for any country to gain at the expense of others by artificially reducing the value of its foreign exchange. A country could depreciate its exchange by printing currency and using it to buy foreign exchange which it hoarded. But this would merely permit the foreign country to get real goods for its printed paper money. The moment the first country began to spend the foreign money it had acquired, the foreign value of its currency would begin to rise again. The value of the currency could only be kept down permanently (without continuing to present the rest of the world with real goods in exchange for bits of paper) by permitting a proportional rise in domestic prices. This would exactly offset the lowered rate of exchange in its effect on imports and exports, and everything will be just as if there had been no change in the external value of the currency. In no case does the country benefit itself or harm others by depreciating its exchange. The only rule needed for adequate stability of foreign exchanges is that each country shall maintain full employment at home.

But although there is no need for an international gold standard, it will be necessary to have some form of world organization limiting the sovereignty of the various nations. No nation can be permitted to build or possess more arms than are necessary to enable it to cope with burglars and the like. Until this is arranged, the war is not really over.

The fundamental principle of Economic Liberalism in the relationship between governments, just as in the relations between individuals, is that each individual, government or person, shall be permitted to do anything that does not affect the well-being of other individuals, but where giving one individual freedom has the effect of permitting a greater infringement of the freedom of others, it is the duty of Economic Liberalism to apply the smaller public compulsion in order to eliminate the greater private compulsion, thus, by a positive act of compulsion, reducing the total degree of compulsion in the whole system.

Armaments which threaten to involve other nations in war are clearly not a purely domestic matter and cannot be permitted to the nation even though to limit armaments is an infringement on its sovereignty. National sovereignty has played an important and progressive role in emancipating society from the institutions of feudalism. But that time is now past and it must be recognized that national sovereignty is not an end in itself but an instrument for the fostering of Economic Liberalism.

There will have to be a minimum list of conditions that every country must satisfy to be admitted to the world organization. If any nation refuses to agree on matters which affect the security of the other nations, the war for democracy will not yet be over, and the threat will have to be removed by force of arms. But if a nation merely tries to exact special economic advantages, it will be a sufficient sanction to cut off economic relations with such a transgressor of the principles of international society.

The conditions of entry into the democratic world society must be reduced to a very minimum, each nation, or any group of people who wish to constitute a nation, having the right to live their life the way that pleases them best, always provided they do not thereby harm the rest of society. The minimum conditions are

1. Freedom of speech, assembly, and publication for all individuals and groups (except those who constitute a present threat of violence against the democratic state), free movement of foreign literature and journals, and freedom to listen to the radio of foreign countries.

2. No discrimination in economic treatment or in economic opportunities against any individuals on account of race or creed or place of birth or anything other than their efficiency in the work they perform.

If a country disregards the foreign value of its currency and increases effective demand at home (to the level which gives it full employment), the increased demand for imports by the newly employed will cause the country's currency to depreciate to the point where the higher prices of imports and exports (in the depreciated domestic currency) have sufficiently discouraged imports and encouraged exports to make them equal to each other again. There is no export balance and the other countries are not harmed. The depreciated exchange is not the *cause* of an increase of employment at the expense of the other countries but a *result* of an increase in economic activity that does not affect the other countries. If all countries completely disregard the effect on their foreign exchanges and create enough effective demand in their domestic markets to give full employment at home, they will all gain in employment, there will be no general depreciation of the exchanges (which by definition is impossible), and international trade will not be hampered in any way.

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2. No discrimination in economic treatment or in economic opportunities against any individuals on account of race or creed or place of birth or anything other than their efficiency in the work they perform.

3. Freedom of movement of nationals and foreigners both within every country and between countries.

4. No discrimination between domestic production and importing goods or between domestic consumption and exporting goods. This will mean that every country shall import any goods up to the point that makes the price of the goods (plus the transport cost) not less than the marginal cost of domestic production of the goods, and shall export goods up to the point that makes the price received for goods (minus the transport cost) not greater than the marginal cost of domestic production.

There are many other conditions that the economic liberal would like to see generally established, but these four minimum requirements would be an adequate safeguard (together with the control of armaments) against the possibility of anything like another fascist threat to democratic sociсty, and they would be a good beginning from which the other virtues of Economic Liberalism could develop. The freedom of movement of people and of news would mean that there could be real competition between different institutional arrangements, and people from all the countries could see them in action, judge between them, and copy the best.

Most directly relevant to Economic Liberalism is the fourth condition. In a completely private-enterprise economy in which there was perfect competition throughout the economy, this condition would simply mean *free trade.* In an economy where all or a great part of the economy was collectivized, the same results of the most complete international division of labor are brought about by following this principle of nondiscrimination.

It is possible for any nation to get better terms of trade with other nations by an appropriate limitation of the goods it imports or exports. If several or all the nations try to play this game, they will all lose from the restriction of international trade. To prevent this from happening and to permit the greatest benefit to all from international trade, there must be some *Rule,* objectively set up so that it cannot be said to have been constructed to favor one nation at the expense of another. Our fourth condition is such an Objective Rule because it is completely nondiscriminatory and does permit the total benefit to all to be the greatest possible. It merely prevents every nation from exploiting any other nation in its trade and has all the advantages that have been claimed for free trade.

An exception to the third condition would have to be allowed in the case of immigrants from overcrowded countries whose population was regulated only by the Malthusian law of the pressure of population on subsistence. Unlimited immigration from such breeding centers would ultimately reduce the whole world to their own uncomfortable degree of overcrowding without relieving the original pressure. It would therefore be necessary to have some sort of quota for such immigrants into the less crowded parts of the earth, though these quotas could be far more liberal than they have been in recent times.

The inclusion of money capital among the goods mentioned in condition 4 would equalize the marginal efficiency of investment throughout the whole world. Rich countries who save more than their domestic investment opportunities absorb would invest in poorer countries where the opportunities for investment at the current yield are greater than the domestic saving. This would be the most efficient thing to do from the point of view of the best utilization of resources. It seems, however, to be well established that such investment leads to ill feeling when the investors collect the interest on their investments (even where these are genuinely productive and not merely ingenious manipulations whereby backward populations are bled to pay high interest on loans squandered by princes or politicians). Because of this it might be better for the equalization of the marginal efficiency of investment to be sacrificed to some extent for the sake of maintaining good feelings between the different nations.

Fundamentally, the dissatisfaction that poor nations feel when they are paying interest on the money they have hired is based on a feeling of dissatisfaction with the distribution of the wealth of the world not only between individuals but between rich and poor nations. This feeling is genuine even though it has been basely exploited by the Fascists in their propaganda. To equalize incomes in the different parts of the world would involve a quite impracticable reduction in the richer countries. Yet something will have to be done to diminish the great inequalities of income of the different nations as well as between the individuals within the nations. For this there is needed some sort of rule, too, which must have at least the appearance of objectivity.

Such a rule might be found in a solemn agreement between the nations to direct a certain amount of investment toward increasing the capital wealth and the income of the poorer countries. A good

form of this rule would be the principle of half-and-half. The free export of capital and consumption goods, in the manner of lease-lend or an international Works Progress Administration, from the richer to the poorer countries so that half of the annual increase in income per capita for the whole world is directed to increasing the per capita income in each country by an equal amount, and the other half is devoted toward raising the per capita income of the very poorest countries. Of course, there would arise many complicated problems in the management of these funds, but some such simple fundamental principle will have to be adopted to provide the world with the justice that it needs for stability.

The establishment of principles like the four conditions for the admittance of countries to the society of free peoples and the half-and-half principle for the gradual rehabilitation of poor countries, will make it possible for a real new order of democracy to be established because it will permit the *domination* of nations which are backward in the development of their democracy without giving even the semblance of *exploitation*. Domination has usually been accompanied by exploitation, but that is no reason for assuming that this must always be so. While exploitation is the negation of Economic Liberalism, domination by leading democratic nations over *democratically* backward nations, as well as over possible new eruptions of fascism, is a necessary condition for the successful establishment of the democratic new order of triumphant Economic Liberalism.

This essay is rather optimistic. This is partly because the primary assumptions had to be optimistic to permit the question to be put at all, but partly because at the present crossroads of history Liberalism, economic and otherwise, cannot stand still but must either perish or move forward. The very fact that everything is being upset by the war means that the greatest obstacles to the establishment of a regime of Economic Liberalism are being removed. The greatest obstacles are the vested interests of the millions of workers whose livelihood depends on the maintenance of artificially protected industries. The war is removing these resistances, especially to the establishment of the free movement of men and goods, partly by teaching us to overcome our niggardliness in the payment of compensation to those who are asked to make special sacrifices in the general interest, but even more by making it necessary to build the whole world anew. It will be no more difficult to build it on a rational plan, such has been hastily hinted at here,

than to repeat all the mistakes of the past. But for this we must be ready to start on the new plan the moment we can stop the prosecution of the war. Our greatest danger is the cry that is being raised for a breathing spell after the war before we start building the peace. If this is to check a hasty vindictiveness it will be a good thing, but the cure for that danger lies rather in continuing to remember throughout the war what we are fighting for and not letting hate take the place of the sane determination to destroy the threat to democratic civilization. To leave the peace for later will be to forego the special opportunity to build a better world. We are building it now even while fighting, and to postpone the plan till later is to leave the discussion of plans with the architect until after the house is built.

If we overcome this temptation to procrastinate, we shall not only be free to build the new world the way it ought to be; but the knowledge of what we want to build will make it possible for the Germans and other subject peoples of the Fascists to turn against their masters when the opportunity arises. Instead of feeling that they must continue to support their masters because defeat would mean their utter destruction, they will begin to see a hope for themselves in a democratic victory.

Chapter VIII

TRADE AND THE PEACE

Henry C. Simons

The general pattern of wartime economic policy, like it or not (and I mainly do not like it), is now determined, at least in the sense of being now not amenable to much modification by academic opinion and discussion. Its faults are, I think, largely attributable to the distorted economic analysis and the prevailing policy persuasions of the immediate prewar years. But all that is water over the dam. In spite of bad fiscal policies and inept economic leadership, we shall muddle through somehow and, I assume, shall attain the military victories that will enable us to dictate the peace and to determine the main lines of postwar world reconstruction.

If the unhappy contribution of the academic world to wartime policies is now a matter of history, the role of our intellectuals with respect to the peace remains to be determined. The problems of the peace, however remote in time, are still remote from our national thinking and from active political debate. Nor is it clear that political and economic persuasions of the recent past must prevail and misdirect us after the war. Definitive statement of peace terms and vigorous debate about national policies in the postwar period may now be premature and likely to prove divisive. Full and frank academic discussion in this area, however, is not now premature but already belated. It is now that disinterested and politically independent students should strive toward that sound consensus which, if attained, might enable them actually to determine the nature of the postwar world. Soon we shall see whether academic specialists will prove worthy of their responsibilities in this matter or whether, as usual, they will divide into as many camps as there are active political factions, offering their knowledge and rationalizing skills impartially to good causes and to bad.

One great error in the last peace lay in the effort to impose political organization and integration in the face of economic disorganization and separatism. If we could bring about real economic integration and a close-knit structure of world trade, then political

organization on a supranational scale would be easier to attain in the measure necessary for peace and necessary in smaller measure as well. Free trade and free exchange require and permit that rather minimal government which is compatible with democracy and large-scale political organization at home. Likewise, on a world scale, they offer the possibility of enduring peace with that loose and flexible international organization which requires no large sacrifice of sovereignty and autonomy on the part of participating national states, and no large exercise of force by dominant powers.

I am here proposing, as a means to enduring peace, the essential features of a scheme of policy which I have long espoused domestically. Every crisis induces reformers, committed to their various nostrums, to present, as solutions of crisis problems, the same measures which they have espoused in other circumstances and for other purposes. But such behavior demands no apology, save in cases where the proposals were ill-conceived all along. Indeed, if we attain a good peace, it will be built, not from ingenious novel schemes of bright young men or from the opportunism of politicians, but by close adherence to broad principles of policy which have little novelty and which have long been objects of reflection, inquiry, and disinterested discussion. We shall be surfeited in any case with *ad hoc* contrivances. Our intellectual heritage contains all the wisdom which is likely to be fundamentally useful, and all the errors likely to be dangerous, for world reconstruction. Long discussion of old ideas diminishes the risk of our choosing badly among them. But novel schemes, however old in substance, may arouse unmerited enthusiasm and receive unmerited support, just as, at this moment, the best scheme of rationing is the last one we hear about, *i.e.*, the one in which neither reflection nor experience has yet revealed the crucial shortcomings.

It is my firm conviction that nineteenth-century English economic liberalism affords the only promising basis, the only sound principles, for a durable peace. This political philosophy has largely been repudiated in domestic policy everywhere; and, because of that repudiation, Western democracies, I think, might well have been destroyed from within, had they not opportunely been forced to resist the aggression of antidemocratic powers. That free internal trade is a necessary condition for political freedom domestically is not a generally accepted view, although erstwhile opponents have latterly shown signs of growing inner doubts about more romantic schemes of revolution or reform. Hitler has at least shown

us the seamy side of collectivism and raised intellectual inquiry, even in radical circles, from sterile contemplation of policy as choice between an ideal or perfect statism and the inevitably imperfect institutional system based on individual freedom. But the appeal of free trade to internationally minded people has never been wholly lost; and we are now internationally minded as never before, to the extent at least of being prepared to consider seriously how we may spare ourselves an early recurrence of global war after this one is past. If, by wise leadership, political and intellectual, our people can be persuaded that new foreign and domestic policies are indispensable for enduring peace, I see now a real possibility that those policies may be effectuated. Left to our own devices, in splendid, secure isolation, I fear we should have undermined rapidly our own heritage of liberty and abundance. Faced now with the task of creating a tolerable world order, we may both accomplish that end and likewise save ourselves as a prosperous, united, and democratic nation in the process.

The principle of free international trade is now recognized clearly, if not unequivocally, in the Atlantic Charter and the lend-lease agreements. I propose to spell out what this principle means —to consider its implications for action if it is more than a nominal, tongue-in-cheek commitment.

It is useful, at the outset, to recognize that free trade is a nearly meaningless conception where collectivism (or totalitarianism) is present. Try, if you will, to give concrete meaning to free trade between prewar Russia and Germany, or even to free trade between totalitarian and nontotalitarian nations. Barter trade is the antithesis of free exchange, involving a kind of pure collective bargaining that is hardly distinguishable from war—a contest for power whose end is subjugation of the weaker parties. Those buying from a collectivism face a governmental monopolist as seller; sellers to collectivisms face a governmental monopsonist as purchaser; and the monopolist and monopsonist, being one and the same government, will act together in forcing the best terms of trade against outsiders. Small nations, trading with Germany before the war and not dissatisfied with the immediate terms, recognized a steady weakening of their bargaining position and a prospect of subjugation through trade.

Thus, collectivists, facing problems of the peace, are obliged on principle either to espouse a fantastically centralized world order, one great collectivism determining all economic relations from the

top, or to face an endless struggle for power by national collectivisms, each striving to advantage and to strengthen itself as a monopolist against all the rest. Save for those who would rush headlong into an all-powerful socialist world state, collectivists and other statists are simply unable to face or to discuss fruitfully the problems of world order for the future. Here, in plain fact, Hitler is right. A world of national collectivisms must be dominated by one nation or face endless disorder. The whole basis for peaceful economic cooperation through free international exchange is lost with the disappearance of free internal trade. Many of us have argued that free external trade is practically necessary for the preservation of free exchange internally. The converse proposition is simply axiomatic.

For the world, as for great nations separately, the possible forms of stable political organization are of two extreme types. There is, on the one hand, the totalitarian system in which economic and other policies are simply imposed from above by overwhelming power and authority. The Germans contemplate such an order for continental Europe, where military and economic control would be completely concentrated, non-Germans being subject peoples and their economies tributary to the German economy at the center. Dislike this as we may, it is, I submit, the only possible basis for peace if collectivism is the coming order. Nor is it extravagant to impute to its sponsors an objective of world domination. Such an objective is implicit, not merely in the aspiration of a nation or its leaders, but in the whole scheme of policy, and in trade policy especially. Economic and political relations become indistinguishable. Foreign trade becomes essentially an instrument of conquest and exclusion. Access to markets and to raw materials is attainable, on reasonable terms, only by military domination or confederation. In such circumstances, as during the last decade, the distinction between peace and war loses meaning. Order and stability are possible only on the basis of world domination by one authority, powerful enough to direct world production and trade to its own ends. It is apparent to many people that large-scale collectivism (centralization) means tyranny within nations. It should be more apparent that, in the larger framework, it means either world tyranny or endless war.

The alternative world scheme calls simply for a pattern of governmental or political organization in which organization becomes looser and more flexible continuously, and governmental

functions narrower and more negative or preventive, as the units (scale) become larger, until at a world level there exists merely a loose alliance among nations united in the task of enforcing and preserving freedom of trade. There can, of course, be no peace without some exercise of power; and only irresponsible sentimentalists will reject all balance-of-power techniques. The important question is what kind of nations wield decisive power; whether it is exercised, with their willing cooperation, to protect and strengthen the small and weak nations, or to subjugate them; whether it is used to increase liberty everywhere or to promote absolutism and further concentration of power; whether it seeks to promote world prosperity or to increase exploitation; whether it is used to promote world economic integration or economic separatism along regional or continental lines. The crucial practical question, I submit, is whether power is used on behalf of free world trade or against it—to secure special access to markets and materials or to provide such access freely and equally to all nations. One may talk cynically about the motives of the English during the nineteenth century; but one may not now question the good results of English hegemony, in terms of peace and progress.

Our task for the future is, in large measure, simply that of recapturing what was good in the nineteenth-century order—its relatively free trade, its free movement of private capital, its rapid material progress, its confidence in democracy, its emphasis upon individual liberty, and its hope for secure world order. If we would recapture these things, we cannot wisely ignore the political and economic philosophy of their time, the traditional liberalism which flowered at the height of world progress and guided or rationalized the policies on which that progress was founded.

The great issue at the peace will be the issue of individualism versus syndicalism and collectivism—wholesale economic disarmament versus increasing economic armament. In the depression, we sought escape from afflictions by plunging on toward collectivism and by fostering an aggressive syndicalism from which absolutism is the only easy escape. Continuing this line of policy at the war's end, we shall squander perhaps the last opportunity for creating a peaceful and prosperous world, writing *finis* to the brief democratic era of history. We may thus pursue relentlessly the tragic illusion that more and more positive government will cure our ills; or we may reject political romanticism and resolutely construct that dualism of competitive and political controls which

minimizes the need for government imposed from above. Taking the latter route, we may restore throughout the world the rapid material and moral progress which characterized the ascendancy of English economic liberalism. Adopting this policy, however, we must again cherish outmoded political ideas, especially the idea that good government means minimal government and full exploitation of the possibilities of impersonal, objective control through free, competitive markets. But, while we must choose between totalitarianism and a minimizing of imposed government, what now calls for emphasis is the necessity of minimizing government on a large scale—of reversing a trend toward statism via centralization. What small nations do, or states and provinces, is not critically important. They may undertake all kinds of experiments—Socialist, Communist, Fascist, what you will—without much endangering thereby the peace of the world. Such adventures cannot seriously threaten general security if they are conducted within the framework of a free-trade system. For small political units have in fact little power to restrain trade.

The great threat to world order lies in large-scale, centralized national systems, for such systems are incompatible with that larger scheme of world organization which is the alternative to absolutism or chaos on a world scale. Great centralized nations are insuperable obstacles to world integration, political and economic. It is only such nations that have large power to restrain trade; and it is precisely in such political units that it becomes impossible to protect the common domestic interest in free trade against the special interests of producer minorities in restraining it. The larger the area governed by a legislature, the weaker are the defenses of democracy (or of dictatorship) against special-interest pressure groups and political logrolling. We must either limit drastically the positive functions and activities of large governments or accept both internal disintegration of democracy into syndicalism and increasing nationalist barriers to world trade and peace.

Centralization, in fact, is, like "planning," merely a weasel word for collectivism; and it presents, with minor differences in degree, the same obstacles to world order. Both, moreover, are the essential and significant manifestations of those excesses of nationalism which, whether leading to aggressive conquest or to defensive withdrawal and isolation, are the great threat to peace. Repudiating the one, we must recognize the need for diminishing the other. Thus, I seriously suggest that, given a crushing defeat for Germany,

the major obstacle to durable peace will be the United States and its excessive governmental centralization.[1]

American economic policy will largely determine the significant future of the world. We shall decide whether the best potentialities of the mid-nineteenth century, frustrated by resurgent economic nationalism and Prussian militarism, will be realized in an again prosperous, progressive world; or whether the world will quickly resume a political and economic trend which the defeat of Germany is intended to reverse. If we do commit the Western world to increasing concentrations of power, within nations and among regional blocks (as *Geopolitikers*, German and American, so warmly recommend!), history will show little return on our prodigious investment in this war.

The central question is whether America chooses to be of the world economically or to sustain its economic isolation. If we had no tariff system; if we had no elaborate structure of Federal economic control which depends for its existence and effectiveness on being operated behind a high tariff; if our government had not fostered labor and other monopolies, and producer pressure groups generally, and had not become essentially an agency for their exercise of power; then we might easily assume responsibly the burden of world leadership which our national power imposes upon us.

Political and military isolation we cannot have in any case. Willingly or otherwise, we shall with our allies police the world and enforce indefinitely such peace as we and they enjoy. Horror of still another war may make us resolute and diligent in this task. But, with all our power, it will be an impossible task unless we create the kind of world which calls only for minimal exercise of power and permits its beneficent exercise on behalf of freedom and economic progress everywhere.

For the world, as for our own nation, the possibility of minimizing the task of government lies in maximizing reliance on competitive controls and free-market arrangements. But such controls cannot operate effectively on a world scale unless we utilize them also at home, and unless we permit them to work fully upon us from outside. If we did plunge resolutely in this direction, we might find the task of policing the world not only feasible and easy but

[1] England, in some respects, has moved further from a free economy than we—with her extreme centralization, cartelization, and syndicalism; but England is less important than our country, and her postwar institutional development will largely follow, even be dictated by, our own. The same may be said of the Dominions and our small-nation allies.

rewarding as well, in terms of both our own prosperity and the steady growth of good will and cooperation elsewhere.

It should be clearly understood that such action would cost us far less than nothing in the long view. It is only special interests that gain by our import restrictions; the common national interest is all on the other side. One main argument for governmental decentralization at home is that diminution of Federal powers is the only feasible protection against their abuse on behalf of special producer interests and organized, vote-delivering producer minorities. If we are to be of the world economically, however, the necessary steps must be taken against the most bitter opposition of these entrenched minorities. Their tariff privileges must be wiped out. Moreover, an enormous structure of internal barriers to trade (notably those of labor groups and of patent pools) must be swept away to permit the wholesale transfer of resources which free trade will necessitate, if we are to reap its benefits or even avoid great unemployment during our adjustment to it. Many industries and occupations must share with foreigners the domestic markets now reserved to domestic sellers; many others must let down their bars, to permit influx of labor and investment from these areas adversely affected by freer importation.

However, there was never, and will never again be, such a chance for reorganizing our economy as the war's end will offer. Cessation of war production will in any case require wholesale reallocation of labor and investment. To reorganize as part of a world economy will be little more difficult or painful than to reorganize for economic isolation and recurrent war.

The greatest specific barrier to durable peace is the American tariff and the lesser barriers elsewhere which bold leadership on our part would suffice to reduce drastically or to eliminate. I need hardly observe that piecemeal attack on our present duties or mere continuance of the token policies of the Hull treaties will be utterly inadequate. The tariff structure must be leveled as a whole. If we start the logrolling procedure by dealing with duties one at a time, we shall end up, as usual, with higher rates all around. The only feasible concession to gradualism would be, say, an initial overall reduction of 75 per cent, with promise of continued reduction afterwards. But even this concession is dangerous. To concede gradualism here might well be to fail in the whole task at the only promising or opportune time for action.

But tariffs, while the main problem, are by no means the only problem of world trade. Durable peace implies extirpation of bar-

ter trade, of quota limitations, and of arbitrary exchange controls. Moreover, absence of import restrictions is not free trade unless foreign buyers can deal with competitive sellers, and foreign sellers with competitive buyers. Free access to materials means free access to free markets, not the privilege of dealing with monopolies or cartels. It implies willingness among nations to invoke anti-monopoly measures on behalf of foreigners as well as their own citizens, *i.e.*, a policy opposite to that of our Webb-Pomerene Act. And the general principle here calls for prevention of labor monopoly quite as much as enterprise monopoly. Removal of tariff barriers will go far as an antimonopoly measure in most directions; but there can be no free access to raw materials unless the nations possessing them assure competitive prices and competitive labor costs in their production.

All this may sound impractical and visionary. If so, it is no more so than durable peace itself. The peace, I repeat, will be won or lost on the issue of free trade. To be sure, free trade is not enough; but it is the *sine qua non;* and it is the only thing that cannot easily be attained. If we attain it, the rest will be relatively easy. The trends are favorable in other directions. Monetary expansion and fiscal cooperation we shall have in any case, perhaps excessively.[1] Capital movements will doubtless be promoted by many devices, also perhaps excessively.[2]

[1] My own predilection is for essentially independent currencies (or currency blocks), each stabilized in terms of an inclusive domestic price index, and all traded freely (*i.e.*, without intervention by central banks, treasuries, or stabilization funds) on well-organized exchange markets (forward and spot). It is hard, however, to point an easy or promising course toward such a monetary world. Trying to attain it after the war might easily result in our attaining something disastrously different. Moreover, expediency appears to dictate going along with advocates of a return to gold, since they almost alone are profoundly right about issues as to trade and trade barriers, and supporting a dollar standard with a gold façade. If we were to stabilize the dollar, in terms of an index weighted heavily (as it almost inevitably would be) with international goods, then fixed exchange rates among the important nations (if satisfactory levels could shortly be determined and agreed upon) might work out well enough to make the issues here relatively unimportant, at least for many years. Any successful monetary arrangements, to be sure, will require continuous consultation and cooperation among the leading nations, especially as to fiscal or budgetary practices. Radical long-term reform in private finance and financial institutions seems also imperative.

[2] Capital export, after the war, will present very hard problems. Much good can be accomplished by governmental export of food to areas of great need. I trust we shall act boldly and generously on this score, toward both our allies

The difficulty is, first, that leaders will be defeatist from the start on tariffs and trade, as they now are generally in Washington about the American tariff, and abroad because of that defeatism here. This means that we shall have excessive emphasis upon monetary expansion and governmental export of capital—upon financial expedients which, while useful parts of a broad, balanced program, may be merely dangerous by themselves without free trade and likely to divert attention from that basic requisite. It means also, in the case of leaders like Wallace and Milo Perkins, an effort to use the peace as a means for creating supranational agricultural cartels and thus for creating more trade restraint, on the plausible ground that it is politically difficult to create less. Incidentally, the otherwise laudable current emphasis on the world's nutrition would sound better if it did not come from leaders of an already too powerful agricultural block, and if one did not detect the strongest implications of increased public subsidy to agriculture in all the fine talk. Mr. Wallace, finding good causes politically unpromising, can be expected once more to expend his zeal and power on bad ones. The state department, save for the aging Mr.

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and our erstwhile enemies, and that little or no repayment will be asked or expected. But we should distinguish sharply between humanitarian contributions and foreign investments. I have no stomach for the purchase of solidarity, hemispheric or other, by governmental loans to governments. Some governmental lending may be useful, if used cautiously to break the ice and to start private lending in directions where it may safely and profitably go without the flag. This means that loans must be confined largely to countries with stable, democratic governments (including China). On the other hand, we should be chary indeed about giving financial support to politically backward nations and their absolutist governments. Foreign lending, especially by governmental agencies, threatens grave political difficulties in the future, if made in areas where property generally is insecure and financial (fiscal) responsibility not well established. Hard choices will arise in some cases; some purely political lending may be advisable; but, in general, policy should aim at promoting free movement of private capital, taking its own political and economic risks, and should recognize that the areas of such movement cannot be extended rapidly. Where private funds cannot safely go, government must recognize grave political dangers. Our close friends and wholly belligerent allies are clearly the best risks, politically and economically; and Germany's claims, I suspect, will seem far superior to those of most neutrals and nominal belligerents. Investment in Germany, moreover, will be investment in the reconstruction of democracy at the crucial point. Much the same may be said of China. But India and South America, among others, evidently want mainly to be left alone, to develop democratically or otherwise; and, while opening our markets to them, I think we should mainly leave them alone investmentwise.

Hull and his small faction, evidently may be trusted to avoid the tariff issue and to spend its efforts on trivial or dangerous devices of capital export. The National Resources Board and other planning enthusiasts will ignore the tariff issue, partly because it is dull and partly because high tariffs are indispensable for other "planning," centralizing schemes.

It is not an attractive picture, if one is looking for sound leadership—for leadership which will challenge the economic isolationism of Republicans, manufacturers, labor unions, and farmers—for leaders who will risk their own power and status in espousing broad principles of policy and in inviting the attack of special pleaders generally. But I cannot be pessimistic, if only because the outlook for American economic policy is, to say the least, less bad than it would have been without the war. No one can honestly hold out hope for a durable peace without free world trade; and, with proper public discussion, our people might accept it as the price of peace and as the only basis on which we can undertake, with hope for the future, the inescapable responsibilities of world power. That wise leadership will not appear is not certain. The chances depend in part on the nature of academic discussion now.

Let me indicate some implications of this general position, first as regards Germany.

Germany must of course be disarmed and kept militarily impotent for many years. Defeat, however, should, I think, fall short of the debacle which would deprive her of all defense against her neighbors or against internal anarchy. And I am not much interested in reparations issues. What the peace should impose upon Germany is the kind of political and economic structure which will enable her eventually to participate with full privileges in a peaceful and prosperous world order. This means, first of all, drastic governmental decentralization, without dismemberment, save for Austria, of the pre-Munich Reich, but with dispersion of power among the German states and perhaps with dismemberment of Prussia (certainly with drastic land reform). Germany should be compelled to reduce her tariffs by 75 per cent and to continue reduction further, as a condition of acquiring equal trade privileges in world markets. She should be compelled, not only to abandon barter trade, quota restrictions, and arbitrary exchange controls, but also to dismantle her cartels and industrial combines, giving foreigners access to internally free markets for their exports and imports. She should also be forced into a pattern of responsible,

representative government. When she has met these requirements and reestablished democratic institutions securely, she should be admitted to full participation in the League and to equal privileges in the markets of the world.

Russia presents, of course, a special problem; but I incline toward the sanguine view that she is not really expansionist and that she would not prove an obstacle to any scheme of order in the Western world which promised her real security. Indeed, given a good peace, I should expect Russia to adapt herself gradually to Western democracy and to abandon the extremes of collectivism. For the significant future, however, she would remain a problem as a participant in an otherwise free-trade world, since, to repeat, there can be no free trade with a collectivist state. Her allies, however, might reasonably ask her to eschew barter trade or, at least, to eschew practices of discriminating monopoly in her dealings with different nations; and Russia has little to lose, even on a short-sighted view, by making such concessions.

Germany can hardly expect us to move apace with her in military disarmament. In economic disarmament, however, she may reasonably expect us to impose upon ourselves all that we ask of her, both by way of tariff policy and by way of extirpation of monopoly and monopolistic restraints in all domestic markets which can, even at the cost of drastic measures, be rendered effectively competitive and free.

Finally, now, a word about federation among the democracies. Here is a movement which has recruited the best of internationalist sentiment in many countries—a movement which has done much to lay the basis in public attitudes for a good postwar order. As to interim arrangements, there can be no issue. The Allied nations, joined in war, must remain virtually federated for many years thereafter, to police the peace and to get some kind of postwar world working and producing again as a going concern.

While federation with England, the Dominions, the Low Countries, Norway, and Sweden has for me a deep sentimental appeal, reflection leaves me little impressed with its merits as a means to peace, and much impressed with its dangers. There must be a close alliance among the profoundly democratic nations and with others who share their interest in the preservation of a territorial *status quo*. But federation implies more positive, supranational government than alliance; it leaves wider scope for common, restrictive measures of economic policy; it sharpens unduly a distinction among our

actual allies, as between those who are of us and those who are merely with us as a matter of accident or convenience; it is inflexible and exclusive; and it is fraught with dangers by way of trade restriction and trade discrimination.

Federation, to me, implies an excessive emphasis upon political forms, at the expense of the vital issues as to content of policy. It may be useful (1) for military collaboration, (2) for monetary and fiscal collaboration, (3) for moderation of immigration restriction, and (4) for customs union or tariff modification. But military collaboration can be attained less formally and perhaps just as effectively without actual federation, and without jeopardizing the affiliation of friendly powers not eligible for federation. Monetary and fiscal cooperation seems also attainable in adequate, even excessive measure without formal political integration. As to immigration, federation would involve only nominal change, since our own restrictions are not now important in the case of our close friends; and, without altering circumstances substantially, it would further aggravate the feeling of discrimination in an area of policy where real mitigation of discrimination is neither politically feasible nor even wise. Thus, in this area, federation would help our close friends very little and annoy other peoples considerably.

Worst of all is the prospect as to trade policy. One need only look at American history to see at what price, in terms of restraint upon external, world trade, one purchases freer trade within a federal system. Our Federal government, conceived as an agency for preserving free trade among the states (which never could have restrained trade seriously in any case), became under the Republicans essentially an agency for preventing trade with the rest of the world and, more recently, a powerful agency for restraining, and facilitating restraint of, our internal trade. What can assure us that larger federalisms will not similarly be abused by the pressures of producer minorities? Let us not fail to recognize, in this connection, that customs union between two nations having identical duties may well make those duties vastly more restrictive of world trade than they were when levied by the two nations separately. The desirable policy is not removal of tariffs against our close friends but drastic general reduction of duties by all Allied nations, and without discrimination, save possibly as one means of inducing parallel action by other nations. The objective is not free trade among regional or linguistic blocks but the freest world trade.

Federation might well lead us toward the former objective at a disastrous price in terms of the latter.

Thus, in contrast with alliances, federation is likely to divide the world dangerously into blocks—trade blocks, migration blocks, monetary blocks—and to promote a kind of regionalism or continentalism which bears unduly close resemblance to Nazi blueprints for the new order. This consideration invites further emphasis on the issue of collectivism or statism versus individualism. The statists and collectivists must stress federation, as a means to the extension of imposed government on a still more intensive and extensive scale. Individualists, in the tradition of nineteenth-century liberalism, may well look askance at schemes for setting up potentially greater Leviathans, and should themselves urge reliance upon more flexible, less formal organization and upon return to the League of Nations, as essentially a forum for discussion of issues and airing of grievances, and as a flexible agency for promoting open cooperative action in world affairs.

The good future of the world, if I may use a favorite thesis of Prof. Viner, is the good future of small nations. Its menace is great federalisms like Germany and the United States, in which government from above grows steadily at the expense of government by states or provinces and by smaller units wherein the processes of democracy have their origin historically and their only strong foundations. It is the great nations which really restrain trade; it is the great nations which give rise to global war. In them democracy becomes degraded into rule by and for organized minorities; in them we find political romanticism rising to supplant the older liberalism which nurtured democratic progress and remains among the important ideologies its only true friend. We must aim, I repeat, at a total scheme of world order in which political organization becomes looser and more flexible continuously, and governmental activities narrower and more negative, as the scale of organization becomes larger.[1] On this view the function of a world

[1] Nothing in this chapter is intended to argue for weakness in government, national or international. The phrase *loose and flexible organization* may, for many purposes, best be interpreted to mean, not weak government, but strong government with a narrowly limited sphere of action. In world affairs we should aim at an inclusive and ultimately universal federation, to which peoples as well as governments would recognize responsibility and allegiance. If such world organization is to be established effectively and to persist, it must limit, but not grossly impair, the sovereignty and independence of national states. Its imposed government or interference with internal affairs must be

state is not so much that of governing the world as that of preventing great nations from governing it. The ideal world state would thus be mainly a repository of powers denied to nations (and to monopolies), held not for exercise from above but merely to prevent their exercise and to assure that systematic dispersion of power which is the only guaranty of liberty at home and the only hope of enduring peace for the world.

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closely confined to measures necessary to prevent war and (largely as a war-prevention measure) to maintain substantial freedom of world trade. While it should promote and facilitate international cooperation in many phases of government, the economic-policy framework of all its activities should be determined principally in the three areas of commercial, monetary, and monopoly policy. Seeking united and cooperative action in these three areas and in the policing of the peace, it should otherwise do little "governing" (save in backward colonial areas entrusted to its administration). History may not encourage advocates of large-scale government with limited delegated powers and a narrow sphere of action, but the conception must guide and inform any intelligent planning for an orderly, democratic world.

PART III

Statistical Information and Economic Policy

Chapter IX

ECONOMIC STATISTICS AND POSTWAR POLICIES

Wassily Leontief

I

A very close connection exists between the evolution of economic policies and the development of economic statistics. Mercantilist protectionism of the seventeenth and eighteenth centuries required an early recording of national import and export figures. The emergence of systematic central banking and monetary policies in the nineteenth century gave impetus to the registration and publication of figures pertaining to gold movements and the variation of interest and exchange rates. Wage statistics originated as a necessary implement of modern social legislation. Every time a new era of economic activity became the object of public concern, it also came under the scrutiny of official statisticians.

With the advent of the New Deal in the United States, the ever-widening stream of figures swelled until it reached the proportions of a veritable flood. Hardly any aspect of the economic life of this country remained unrecorded or uncharted. We registered the monthly change in the price of corn as well as the weekly shipments of oil, the hourly wages of "push press operators" as well as the annual output of hydrochloric acid. The insatiable curiosity of official statisticians has not yet found its limit. On the contrary, with the introduction of wartime economic controls, it has received its greatest impetus.

II

If volume, variety, and accuracy of figures were all that were required of factual information, the responsible directors of our postwar economy should be well satisfied with the present state of official statistics. If, however, integration is added as a necessary and even primary attribute of good statistics, we must be seriously concerned over the present state of statistical information. This lack of integration and coherence is not accidental. It clearly

reflects the fundamental lack of coherence in traditional economic policies.

During the free-trade era of the nineteenth century, positive measures of governmental intervention in economic processes were isolated and far apart. Like waves produced by pebbles thrown from a great distance onto a smooth water surface, the effects of the economic measures died out before they had a chance to interfere with one another; thus, they could have been studied separately and in isolation. But the stones of modern economic policies are thrown in great number, and they fall very close to one another. Interference is the rule rather than the exception; moreover, some of the stones produce not small ripples, but rather tidal waves which reach, in ever-increasing circles, the very limits of the whole economic system. Separate effects cease to lead an isolated existence and must be considered in a totality of mutual interdependence.

Theoretical economists observed long ago the limitations of what is technically called *partial analysis*, and they are now paying ever-increasing attention to problems of *general equilibrium*. For reasons stated above, however, the statistical information available to them is totally inadequate for the purposes of this type of analysis. The exigencies of the wartime economy are now rapidly changing the whole orientation of our economic policies. Although the old-style approach still dominates the organizational scheme and the operational procedure of the economic war agencies, the ever-increasing tendency toward uniformity and coordination of all the different phases of the economic war management asserts itself with relentless logic; and the inadequacy of available facts and figures—until now only the subject of futile academic complaints—becomes a matter of urgent administrative concern.

There is good reason to believe that at the end of the war we shall find ourselves not only in possession of a theoretical program of economic policies and a well-coordinated system of governmental machinery—to put this program to work—but also equipped with a new and adequate background of integrated quantitative information.

III

The economic problem of postwar adjustments is, to a large extent, a question of an orderly reallocation of national productive resources—reallocation which should lead to a continuous full employment of the available labor force. The transition will have

to be realized in such a way as to preserve balanced relations between all the different branches of our manufacture and agriculture, of transportation and distribution. At the same time, the flow of labor and other services from households to industry must be evenly matched by a corresponding absorption of finished consumers' goods by households and of additional investment goods by industries. Not one of these many balances, only a few of which are mentioned above, can be considered in isolation. On the contrary, each has to be treated as part of one large multifarious equilibrium system.

Theoretical economists have tried to report these intricate relationships in terms of a few strategic variables. Some statisticians have taken it upon themselves to depict these generalized variables in terms of indirectly computed aggregative figures. Both these theories and these figures can be conveniently used as arguments in justification of some particular types of policies, but neither can supply a real foundation for a detailed mapping of concrete recommendations or specific actions. The theories require considerably greater elaboration, the statistics more substance and better organization. It is the latter purpose—that of organization of statistical data—which the following scheme of input-output analysis has been designed to serve.

IV

The output, as well as the use, of each of the different commodities produced and of services rendered during any given period of time, say a year, within the borders of our national economy, can be statistically allocated to some particular entity, such as an individual enterprise, household, public body, or a foreign country. Once the structure of the national economy is described in terms of some particular classification of such entities, *i.e.*, in terms of separate industries, households, Federal and local governments, etc., the actual process of production and consumption can be reported in a two-way table showing the origin and the immediate destination of every type of output.

If the national war economy should consist of only (1) a war supplies industry predominately devoted to arms production, (2) a civilian supplies industry engaged in the manufacture of consumers' goods, (3) households, supplying labor services and consuming a certain part of finished commodities, and (4) government engaged entirely in national defense, Table 1 would adequately represent the basic input-output relationships.

TABLE 1.—HYPOTHETICAL INPUT-OUTPUT RELATIONSHIPS IN A WAR ECONOMY
(In millions of dollars)

	War supplies industry	Civilian supplies industry	Government	Households	Total output
War supplies industry		18	36	9	63
Civilian supplies industry	9			36	45
Government					
Households	54	27	9		90
Total outlay	63	45	45	45	

The assumed figures in the top *row* show that the total output of the war supplies industry is valued during a given year at $63 million, of which $36 million are purchased by the government, $18 million are used in civilian production, and $9 million are destined for household consumption.[1] The second row indicates that, of the $45 million of civilian-type goods, $9 million are absorbed in war production and $36 million are purchased by households. The third output row remains entirely vacant, since government is assumed in this example not to be engaged in any productive activities. Households supply labor and other services to the two industries, as well as to the government; the total value of the labor and other services, *i.e.*, the national income, equals $90 million. Of these services $54 million are used in war industries, $27 million in civilian goods manufacture, and $9 million are employed directly by the government.

Examining the figures entered in the first *column*, we see that the war supplies industry absorbs $9 million of civilian-type materials and pays out $54 million for labor and other services supplied by households. The wage bill of the civilian supplies industry amounts to $27 million, and this industry uses up $18 million of materials produced by the war industry. The total governmental expenditure equals $45 million; $36 million go to the purchase of war goods and $9 million for payment of governmental employees. The last column shows the distribution of consumers' expenditures; $9 million are devoted to the purchase of commodities produced by the war industries, and $36 million are paid for civilian supplies.

[1] Our assumption is that the war supplies industry produces also some commodities used in household consumption and in civilian goods production, while the civilian goods industry supplies some materials for war production.

The total outlays (costs including income paid out) of the war supplies industry equal the aggregate value of its output; the same is true of the civilian supplies industry. The household outlays, *i.e.*, the total purchases of consumers' goods, however, amount to only $45 million, while the national income—the aggregate value of services supplied by households to industries and government—is $90 million. The difference of $45 million is transferred to government, presumably in the form of taxes and loans, which has no other source of revenue.

V

Even more important than these *value* figures are the underlying relationships between the actual *physical* quantities of commodities and services produced and used by the two industries, by households, and by government. The difference between the two types of figures (physical quantities and values) roughly corresponds to the division between the problems faced by the Office of Price Administration and those of the War Production Board.

Instead of taking some new example, let us utilize the data of Table 1 to indicate the practical use that can be derived from the knowledge of physical relationships. Assume that the previously discussed figures represent, now, not dollar values but physical quantities—tons of iron, yards of cloth, and millions of labor hours.

In producing the total of 63 million tons of products, the war supplies industry absorbs 9 million yards of civilian-type supplies and 54 million man-hours; while the civilian supplies industry takes 27 million man-hours and 18 million tons of goods produced by the war industry to turn out 45 million yards of cloth. Households supply the total of 90 million hours, and they consume 36 million yards of cloth and 9 million tons of commodities produced by the war industry. Although the total output figures can be interpreted as describing the total physical output of each particular industry, the total outlay figures placed at the bottom of each column must now, however, be entirely ignored. Tons of iron, yards of cloth, and man-hours can, obviously, not be added together.

The proportion of the quantity of each different material or of the labor absorbed in any industry to the size of its total output is not an accidental and easily variable relationship; the bitter experience of recent years has shown us that. The distribution of household consumption among the different types of commodities, as well as the relationship between the national standard of living

and the total supply of labor and other services, is much more flexible, but, nonetheless, highly significant.

VI

Accurate knowledge of these particular relationships is indispensable for any intelligent mapping of the transition from a wartime to a peacetime economy. Such transition must satisfy a number of special conditions. In terms of our simplified example, the change to a new peacetime system must (*a*) eliminate the production of war materials for the government (some products of this industry are assumed to be used also in household consumption), (*b*) maintain full employment of all available labor forces, and (*c*) increase the national standard of living, while providing at the same time a definite, although changed, proportion between the quantities of the two different types of commodities available for household consumption. What is particularly important, all these changes must be accomplished within the rather rigid limits set by the technical characteristics of each of the two separate branches of production; each industry in the peacetime economy has to be provided with the proper combination of labor, material, and all other factors of production.

If we assume the prewar ratio between factors used per unit of output in each separate industry to be unchanged, and anticipate a new proportion (17:73 instead of 1:4) between the household demand for war industry products and civilian goods, we can construct a new input-output table of the postwar economy with full employment, which will satisfy all the foregoing conditions. Omitting the description of the necessary theoretical computations, we give in Table 2 the final results.

TABLE 2.—HYPOTHETICAL INPUT-OUTPUT RELATIONSHIPS
In a Peacetime Economy
(In millions of dollars)

	War supplies industry	Civilian supplies industry	Government	Households	Total output
War supplies industry		32		17	49
Civilian supplies industry	7			73	80
Government					
Households	42	48			90
Total outlay	49	80		90	

Comparison of the new postwar input-output table with that for the war economy shows that the total employment is the same in both. In the postwar economy, government purchases are entirely eliminated; the total national income is spent on consumers' goods used by households. At the same time, the amount of factors used per unit of output in each of the two separate industries is the same as before. The relation between the consumer demand for civilian goods and for products of the war industry is changed, as expected, from the 1:4 ratio to that of 17:73. The standard of living is considerably increased over that of the wartime period.

VII

The oversimplified example discussed above has, obviously, no material relationship whatsoever to the actual economic world. It indicates, however, the *type* of analysis upon which any intelligent and integrated economic policy must necessarily rely.

Instead of two industries shown above, our economic system consists of many scores of various branches of production, consumption, and distribution; instead of a homogeneous labor force as indicated above, we have to think and act in terms of many different professions, skills, and occupations. The transition from one type of output to another involves not only provision of necessary labor and materials, but also the construction of additional plant, and the installation, transfer, or conversion of industrial equipment.

Comparison of the real economic world with the simplified figures of our tables gives a fair measure of the task that the governmental statistical services are now facing. They must be prepared to describe all the relevant, quantitative characteristics of our national economy, and to present them in a form as integrated as are the figures in our fictitious example. Large volumes of heterogeneous statistical figures, however accurate they may be, obviously cannot fill the bill; integration and coordination—with preservation of all details—are of foremost importance. Recent developments, notably in the field of national income statistics, seem to indicate considerable progress in the right direction.[1]

Only when the described task is fairly well accomplished will the national economic policies actually acquire the necessary scientific foundation of factual information.

[1] A forthcoming publication of the Postwar Division of the Bureau of Labor Statistics will present the first large-scale attempt to describe the structure of the national economy in terms of a single input-output table.

PART IV

Fiscal and Related Problems

Chapter X

POSTWAR PUBLIC DEBT

Seymour E. Harris

We are all interested in keeping the public debt at a minimum figure. Yet, despite all our efforts, the Federal debt may well rise by $60 to $70 billion annually in the course of the war. When the war is over, we shall be fortunate indeed if the Federal public debt is less than $200 billion. It is possible that the accumulation of debt, which has been growing for 12 years, will cease once the war ends. If, however, our economy is stagnating and private enterprise fails to keep our resources fully employed, debt will continue to rise. With the likelihood of the reduction of military expenditures from $100 billion annually in wartime to $5 to $10 billion in the postwar period, there will be need for great efforts by the government to prevent a debacle.

The object of this essay is to suggest the broad considerations that will determine debt potential. The conclusion reached is that those who now cry "wolf" at the prospect of a public debt of $200 billion are alarmists reminiscent of those who promised disaster in the thirties when debt was accumulating at the rate of $5 billion annually. We must not, therefore, be deterred from public investment by these alarmists, if the postwar situation calls for public investment. Above all, we should assess the rising public debt in terms of the economy which must support it. There is no danger in a rising public debt which provides the income to finance it, or which grows in a developing economy.

How far we can go in increasing public debt will depend upon (1) the attitude of the country toward debt repayment; (2) the nature of the assets acquired against the new debt; (3) the other burdens imposed on the economy by the government; (4) especially important, the level of income which largely determines tax capacity (the income will be determined partly by the policy of public investment); and (5) the tax capacity of the country which, among other things, will be a function of income and the structure of the tax system. These determinants will now be examined in turn. In

the present discussion it is assumed that the dollar retains its current, *i.e.*, 1942, purchasing power. A crucial issue, the rate of interest, is skimmed over here. Its importance will be made clear in the presentation of estimates of costs with and without interest payments.

THE ISSUE OF REPAYMENT OF DEBT

Obviously the country can countenance a much larger public debt if repayment is not required. Until recent years, a fundamental principle of public finance had been that large public debts, which as a rule were incurred in wartimes, should be paid off in the ensuing periods of peace. In practice, however, repayment has been the exception rather than the rule. Frequently the economy grew up to its debt; in other cases, the debt was repudiated openly or there was disguised repudiation through capital levies, currency depreciation, or a compulsory scaling down of the interest charge.

The argument against debt repayment today rests largely on economic grounds; but the charge of breach of faith is also refuted. In answer to the contention that a permanent debt is a breach of faith, it is suggested that the obligation of the government is merely to provide the cash value of the bond on the date of maturity: the cash required may be obtained through sales of new bonds. Repayment of debt, moreover, may have deflationary effects; and the more impressed one is by the theory that our economy tends to stagnate, the more objectionable is the repayment of debt. Another point raised against debt repayment—and one obviously not to be used by stagnationists—is that the country will continue to grow. A steady rise of income of $1 billion per year (less than 1 per cent of current income) can easily finance an increase of debt amounting to $5 billion yearly. In other words, an increase of income of $1 billion at the present income level can provide Federal taxation of $200 million or more, which is in excess of the additional annual debt charge of $125 million, the cost of a debt of $5 billion at an interest rate of 2½ per cent. (The unfavorable assumption is made here that the public investment, which accounts for the rise of debt, does not yield income directly; and no allowance is made for a further favorable effect of the rise of public investment on income.)

Here is the gist of the matter. Accumulation of debt will not bring ultimate collapse if the economy continues to grow. Tax capacity increases with the rise of income; and so long as the rise of

debt charges is kept well within the limits set by a rising trend of income and capacity to pay taxes, no fears need be felt concerning a rising public debt. But a continued rise of the cost of the debt in the face of stable or, even worse, falling incomes will ultimately bring disaster.

THE NATURE OF THE ASSETS ACQUIRED

In a discussion of the burden of the public debt, one should deduct from the debt the capital value of assets yielding net income.[1] But governments necessarily invest also in schools, asylums, and other projects which do not yield money income directly. Expenditures are, of course, restricted by limitations of the national income and by the income of the various governments. The larger the national income or (and) public incomes, the more generous expenditures on nonincome-yielding assets may be.

These expenditures come within the province of the capital budget. Interest on the debt incurred, cost of maintenance, and amortization over the life of the asset are the annual charges to be met in connection with any particular project. An important offset may be savings on relief and favorable effects upon income and tax yields. Effects on tax yields, however, are not easily measured; and the long-run effects upon income of better education and an improvement in health are not easily measured either. We may be reasonably sure that the higher the level of unemployment, the more important will be the rise of income and tax receipts associated with a rise of public investment.

Public investment in self-liquidating projects arouses even more debate than that in nonincome-yielding assets. By a self-liquidating enterprise, we mean one that pays for itself on a proper accounting system over the life of the relevant assets; not as a high administrator in the early New Deal days suggested, one that improves the health and morale of the American people. Adherents of our system of free enterprise oppose government investment in

[1] It has been estimated that of $50.7 billion spent by the government in the years 1931–1938, $14.5 billion had been invested in assets and $2.9 billion of the assets had been amortized. Furthermore, against a rise of debt of $24.8 billion of all governments in the years 1931–1938, are to be put net construction ($16.5 billion), proprietary interest of the Federal government ($3.3 billion) and a rise in the general fund balance ($6.3 billion). *T.N.E.C.* Hearings, pp. 4090–4092, 4149. *Cf.* my *Economics of Social Security* (New York, 1941), pp. 38–40. These figures are presented for illustrative purposes. It is impossible for the outsider to attest their accuracy.

self-liquidating projects on the grounds that they contribute to the building up of a vast bureaucracy, and that, in fact, they are often not self-liquidating. These opponents will generally concede that there are certainly special reasons for public investment in restricted areas. Where capital costs are large, the government's cheap credit may make possible profitable investment instead of no investment. Housing is the best example here. Again, when risks are excessive frequently the government alone is in a position to undertake the investment. Investment in armaments is a case in point.

In this connection, a word should be said on a related issue, *viz.*, the relation of debt and prosperity. Supporters of public investment have frequently commented on the rise of total debt in periods of prosperity and its liquidation in periods of depressions. They have drawn the conclusion from this observation that public investment and deficit financing should be encouraged in periods of depression. In taking this position, however, they leave out of account the fact that, in the process of incurring debt, private enterprise presumably acquires income-yielding assets. This is not, of course, always the case. But, in general, private enterprise would be more likely to acquire income-yielding assets than would public enterprise. Another inference that might be drawn from this argument for a rise of debts in periods of prosperity, *viz.*, the desirability of a large debt structure, would not receive general acceptance. A rise of debt may contribute to an increase of income and an improvement of business conditions; but the larger the fixed charges, the more harmful would prove the failure to realize expectations.[1]

OTHER PUBLIC CHARGES ON NATIONAL INCOME

At an income level of $70 billion, the governments (Federal, state, and local) of the United States were raising $14 billion through

[1] *Cf.* Appendix A of *The Economic Effects of the Federal Public Works Expenditures*, 1933–1938 (Washington, D. C., 1940), pp. 112–113. Here it is shown that total public and private debt rises in prosperity and declines in depression. "For the public debt as a whole, however, the transfer problem is the same as for private industry. The pressure of the debt on the tax base depends on whether there is a continued flow of borrowing, public or private, and whether, accordingly, incomes are maintained. In the case of both public and private debt the long-run burden is not a question of absolute magnitude but of the size of the flow of income from which debt service is drawn, and as the economic system is organized that income depends on a steady volume of borrowing and investment."

taxation, *i.e.*, 20 per cent of national income. Total expenditures were larger than tax receipts by several billion dollars. In the postwar world, the cost of government will probably continue to rise as it has in the prewar world. Undoubtedly, our war plant, even after the present emergency, will involve us in increased military expenditures of at least $5 billion. The increased cost to the taxpayer of the probable security program may well come to $7 billion annually, or more. In addition, we should not leave out of account the demands of veterans (*e.g.*, of the Second World War), farmers, Townsendites, and other pressure groups. A possible Federal budget for the postwar period may be the following:

	Billion
Predefense budget	$ 8
Increased expenditures for social security, public works, etc.	10
Increased military expenditures	7
Increased cost of public debt	5

Postwar expenditures of all governments may rise to $45 billion, which at an income of $140 billion would equal a tax burden of 32 per cent of the national income, which may not be excessive. Insofar as the debt rises more than $200 billion, additional expenditures for financing the public debt will be even higher. (We discuss that possibility below.) Income is ultimately likely to exceed $140 billion. In summary, the vulnerability of the economy to a large public debt will depend in no small part upon the other charges on the taxpayer; and the total of fixed charges on industry, inclusive of taxes, is not an irrelevant consideration. Falling prices, moreover, would accentuate the dangers.

THE SIZE OF THE NATIONAL INCOME AND THE TRANSFER BURDEN

An increase in population, a continuance of technological and organizational changes, and the avoidance of long periods of large amounts of unemployment will assure the country a steady rise of national income, which is a *sine qua non* for the financing of a very large and growing debt.

The total charges on the economy must not be allowed to grow to a point where the national income begins to suffer seriously. Taxation, unfortunately, is a burden even if levied for financing transfer payments (*e.g.*, for interest on the public debt): a country with a public debt of $100 billion is not so well off as a debtless country. It is, therefore, imperative to provide a tax system which

will cause the minimum amount of harm. Other things being equal, the burden of taxes will be greater the larger the proportion of taxes put upon costs rather than upon surpluses. Again, excessive consumption taxes tend to depress both consumption and investment and, therefore, have adverse effects on income. In conditions of full employment, however, taxation on consumption will not have adverse effects on income.

Let us discuss more fully the burden of transfer payments. Assume that the government raises $10 billion annually through the sale of bonds, because it cannot raise this money through taxation without adverse effects on the economy. The purchasers of bonds are more disposed to purchase $10 billion (say) of bonds than to pay an equal sum now in taxation. And the government can much more easily raise $250 million by taxes annually for debt charges—even this amount may be borrowed—than $10 billion by taxes in one year. Although the lender prefers to lend rather than to be taxed, actually he may be worse off under a lending than under a taxing program. Much depends upon who pays the additional taxes. One possibility is that the additional taxes are put entirely upon the rentiers: they pay the additional $250 million of taxes and receive the additional $250 million of interest. In that case, they have really lost their $10 billion; they might as well have paid it out in taxes.

It is probable, however, that the banks will purchase a large part of the new securities; and the taxes will be distributed among the capitalist classes rather widely. Then, on the assumption that the additional taxes will be imposed on capitalist shares, transfers from nonbanking capitalist groups to banks will be required. Sales to banks raise additional problems, which need be discussed only briefly here. The monetary expansion, which is likely to accompany sales to banks, induces higher prices and incomes. It is necessary, therefore, to weigh against the increase of debt charges the ensuing rise of incomes and tax capacity. We are, however, interested here primarily in noninflationary sales. (These may include sales to banks when the level of employment is not high.)

We have seen, then, that the lender may be no better off under a loan program than if he had been taxed an equal amount. He will be better off, however, in lending rather than paying out an equal amount in taxes under some conditions. It is only necessary that a substantial part of the cost of financing the debt be put upon non-

capitalist income;[1] or that the recourse to lending accounts for a significant rise in income. Labor and agriculture will, however, agitate against a tax system which requires that they finance a significant part of the public debt.

What is especially important to observe here is that the use of the tax power to finance interest payments on debt is a real burden to the taxpayer. He feels the burden whether he is a laborer without bonds or a capitalist holding Federal issues. In the latter case, the net yield of the bonds is reduced insofar as he is asked to pay for the financing. For the nation as a whole, however, a billion dollars raised to pay interest on bonds is not nearly so burdensome as a billion dollars raised to manufacture munitions soon to be destroyed, or to build public works of small value, or to pay tribute abroad. In these last instances, the burden is not limited to the adverse effects of greater taxation on the economy: in addition, economic resources are destroyed. (Full employment is assumed here.) Favorable effects of public investment on the national income in periods of low employment are another matter. Public investment gains adherents, moreover, the more useful the objects of expenditure.

Aside from the financial considerations, the announcement effects of heavy taxes requires comment. The potential victim thinks that he is better off under a lending than under a tax program. Against the disturbances involved in the payment of taxes under a severe tax program is to be put, however, the depressive effects of the interest charge in later years. Adverse effects on motivation are reduced under a lending program; but under a tax program depressive effects in the future are substituted.

TAX CAPACITY

The proportion of the economic resources that can be taken by the government depends upon the country's wealth, income, and distribution of income; the nature of the society; the quality of the tax system; the expenditure pattern of the government; and the attitude of the taxpayers toward the spending program.[2]

It may well be that there has been excessive concern over tax capacity. Clearly, much depends upon the source from which the

[1] Rentiers may, of course, be financed by other capitalist groups, *e.g.*, entrepreneurs; and owners of nongovernmental assets may finance the cost of the public debt.

[2] On some estimates of the relation of income and taxes, see Secretary of the Treasury, *Annual Report on State of Finances*, 1940, p. 5, and my *Economics of America at War* (New York, 1942), *passim*.

revenue is obtained, the use to which the money is put, and the time over which the change in tax structure is consummated. Assume that the tax collections of the Federal government are to rise from $5 to $30 billion from 1940 to 1980. (Prices and incomes are assumed to remain unchanged and we leave the war out of account.)[1] Then insofar as the taxes are collected from surplus incomes and expended in such a manner as to increase the marginal propensity to consume, the effects may even be favorable. When the money collected is used for transfer purposes (*e.g.*, public debt financing or insurance), the adverse effects will not be so great as when the money is expended for exhaustive effects.[2] The time may come when taxes on surpluses will be inexpedient, for the attainment of an adequate standard of living may require large additional savings. At this point, taxes on surpluses will be justified only to the extent that cash is diverted from consumption or hoards and will be harmful insofar as real savings are reduced. At such time, moreover, the allocation of public expenditures for investment rather than consumption purposes may also be appropriate.

THE FUTURE OF THE PUBLIC DEBT

In a recent budget speech, President Roosevelt commented on a rise of national income of $30 billion above the depression level, and a rise in the annual cost of debt servicing of only $400 million. So long as a high level of money income could be maintained, he was not concerned over the interest charge. There are, of course, two problems. The first is the relationship between national income and the additional costs of the public debt; the second is the relationship between national income and the income of the government. Despite the rise of national income accompanying a spending program, difficulties may arise in financing the public debt. The government must intercept a sufficiently large part of the rising national income to meet the new debt charges.

Let us assume that the wealth of the country at the present moment is $350 billion. This wealth is not wiped out as debt rises,

[1] One might assume that output will be much larger in the future and, therefore, the problem of finance should not be a cause for concern. (*Cf. Hearings*, Ways and Means Committee, House of Representatives, *Social Security*, 1939, p. 1841). Against any rise of output, one should put the increasing demands that are likely to be made on governments. *Cf.* W. B. Reddaway, *Economics of a Declining Population* (New York, 1939), pp. 195, 207.

[2] We use the term *exhaustive* as it is used by Prof. A. C. Pigou (*A Study in Public Finance*, London, 1929, pp. 19–20).

though a financial or transfer problem is raised. The net effect of the rise of the public debt will depend upon the value of the assets created in the process of public investment and net effects on private investment and national income. The larger the amount of unemployment, the more likely will be a rise in real wealth, and not merely a rise in the dollar value of resources.

Assume, however, that the total wealth neither rises nor declines. Insofar as interest on the public debt becomes a charge on the income from the $350 billion of wealth, less is left for other purposes. This income, however, accrues to someone, possibly to the very people who own the public securities. But, possibly as an unfortunate legacy of the war, the interest on the debt will be financed out of taxes assessed upon wages and salaries, income which has no counterpart in capital value.

Let us assume that the debt rises to an amount in excess of the $350 billion of *other* forms of wealth. The transfer problem then becomes more serious. It is still soluble, however. The required payments to bondholders may be assessed upon them; or in part on them and other holders of wealth; or in part on each of these groups and on labor incomes.

In one sense, there is no limit to the growth of public debt, for, as debt charges rise, the taxation of holders of this debt may rise at an equal rate. Assume that the interest charge is $100 billion and the debt $4,000 billion. National income, *exclusive of interest on public debt,* is assumed to be $100 billion, $70 billion being distributed in wages, salaries, and farm incomes, and $30 billion in payments to capitalist shares. On these assumptions, the annual cost of the public debt would fall largely on the owners of public securities. Noncapitalist incomes might be asked to pay $20 billion and capitalist incomes $80 billion, of which total $60 billion would be contributed by the holders of public debt. Clearly, transfers of $20 billion from labor and agricultural incomes to rentiers would be accepted by labor and agriculture only under strong protest. Net incomes of the investors in public debt (after payment of additional taxes associated with public debt but exclusive of other tax charges) would be but $40 billion or 1 per cent on the debt outstanding. Capitalist interests would react violently if out of an income of $130 billion they were required to transfer $80 billion to the government for the financing of the debt, in addition to their share of other public charges of approximately $35 to $40 billion. Effects on motivation and accumulation would then be serious.

If, in a period of 50 years, we could attain a national income of $200 billion plus the interest on government securities, then a public debt of $4,000 billion might well be within the realm of possibility. The rise of productivity need not be so large as we have become accustomed to in the last 50 years in order to attain this income.[1] It is imperative, however, that the country be saved the losses resulting from long periods of unemployment. Additional relief might be obtained through a slowly rising price level, a reduction of the rate of interest to 2 per cent, and the expected increase of population.[2] The $80 billion required to finance the public debt would then be a charge on $140 billion of noncapitalist income and $140 billion ($80 billion interest on public debt plus $60 billion other) of capitalist incomes.

THE TRANSITIONAL PROBLEM

Two large issues confront the investigator. Can the economy carry the burden of a large debt without collapse? Is the process of accumulation likely to induce a breakdown of the capitalist system? Some attention has been paid above to the first issue, and further comments will be made later. We now turn to the second question.

First, it is obvious that if the creation of additional debt of $4,000 billion involves the manufacture of $4,000 billion of additional bank deposits (*i.e.*, sales of securities to the banks), a great inflation will threaten. But possibly, in the long run, the public will become accustomed to holding a much larger proportion of their wealth in cash; and any ensuing drop in the rate of interest, which might be associated in part with the creation of money, would stimulate the movement into cash.

In periods of depression and severe unemployment, the rise of debt will be accompanied by a rise of deposits of the same order of magnitude. But under these conditions, the expansion of money is offset by a rise of output; and the increase of prices should not be large. As employment rises, however, the stability of prices is threatened. In war periods, the increase of debt and deposits is likely to bring a serious advance of prices, for employment is at a

[1] *Cf.* the essay in this volume by Prof. Samuelson. "Consequently, within little more than the next half-dozen years, we may witness money national incomes of not much less than $170 billion."

[2] The rise of population would be an unfavorable factor in that the income not taken by the government would have to be shared by more people; but the burden of the debt falls as population and national income rise.

high level at such times. That, in a strenuous war, the government takes measures to immobilize the additional cash created tends to reduce the dangers of inflation.

In the postwar period, the creation of debt should involve *diversions* of income (and its cash counterpart) from the public to the government. As incomes rise to a higher and higher level, the proportion of savings to national income increases. If the outlets for savings are inadequate, then the government may sell securities for cash saved out of current income, which would otherwise fail to materialize as investment or consumption. At an income of $200 billion, which is not out of the question 50 years from now, the government may thus well absorb $25 billion or more of net savings annually.[1] If a position of high employment is attained without public investment, or if at any point it is maintained without further public investment, then the accumulation of public debt will cease. As the amount of debt outstanding rises, the rentier class may increase its ostentatious consumption, which in turn may reduce the amount of public investment required. In short, public investment will be required to the extent that private investment and consumption are not kept at a sufficiently high level. And the larger part of the public outlays in the postwar period may result from transfers of cash and savings, not from the manufacture of new money.

Some light on future income is shed by an extension of recent figures of industrial production and output per man-hour into the future (Table 1). Too much reliance should not, however, be placed on estimates for the future. The rise of output per man-hour will depend in no small part upon the level of employment. The losses associated with very high employment will, however, be more than made up by the greater rise of industrial production as employment reaches a maximum. It does not follow from the fact that productivity rose by 100 per cent in the years 1920–1940 that increases of an equal percentage will occur in each succeeding 20 years. Similarly, the rise of production has resulted in part from a rise of population and increased accessibility to raw materials which cannot be assumed for the future. Nevertheless, our past history suggests new gains; and an extension of past trends into the future is informative if not prophetic. Furthermore, it should not

[1] A rise of productivity of 1 per cent yearly, an annual increase of prices of 0.5 per cent, and the anticipated rise of population could easily raise national income to $200 billion in a generation or two.

be assumed that indices of productivity and output are accurate guides of income changes. As productivity and output *both* rise, income should also rise, though not so rapidly as the gain of productivity and not even so rapidly as output in mining and manufacturing.

TABLE 1.—INDICES OF INDUSTRIAL PRODUCTION AND PRODUCTIVITY
Rate of Increase since 1919 Extended into the Future*

	Average 1919–1920	1940	1960	1980	2000
Productivity	50	100	200	400	800
Industrial production	60	100	166	276	458

* This table is based on the Federal Reserve Board index of total industrial production taken from the December, 1941, *Federal Reserve Bulletin*, p. 1263, and on the index of output per man-hour from 1919–1938 in S. Bell, *Productivity, Wages and National Income* (Washington, 1940), p. 270. The percentage gain for the years 1919–1920 to 1940 are applied to each succeeding period of 20 years.

Since our current wealth may roughly be estimated at $350 billion,[1] our Federal debt approximating $100 billion, and our current volume of deposits at $75 billion, a Federal debt of $4,000 billion is at first difficult to visualize. Nevertheless, the Federal debt may well rise to an amount ten or more times the current dollar value of all assets. First, an inflation of capital assets may stem from a large drop in the rate of interest, which affects peculiarly the price level of capital assets. The $350 billion of assets available today may well be valued at $600 to $1,000 billion in the year 2000. It is possible to have a large inflation in this sector of the economy and yet prices of consumption goods may rise relatively little. Second, debt rises at an equal rate with the purchase of unproductive assets by the government. In the present war, for example, the government may well increase its debt by $50 to $70 billion, annually. Debt accumulates and the assets are quickly consumed. The accumulation of debt at the rate of $20 billion plus interest charges (at the rate of 3 per cent) will produce a debt of $4,000 billion within 63 years. Accumulation at the rate of $30 billion plus interest charges will produce a debt of $4,000 billion in 53 years. Third, the government will acquire productive assets. Many of these assets (*e.g.*, schools, laboratories, public roads) will be productive in the long run. They will contribute to a rise of income, though possibly the investment will not be repaid in full.

[1] See National Industrial Conference Board, *Economic Record*, Oct. 5, 1939, p. 115.

Assets of this type may not, however, offer an adequate outlet for the excess savings. Then it would be necessary for the government to invest heavily in enterprises that compete with private investment—in housing, public utilities, and other fields where the low rate of interest available to the government makes investment profitable. The marginal net *social* product may be positive, whereas similar investments by private enterprise may yield a negative or inadequate marginal net product.[1]

The government may take the longer view; and the effects on *total* income and even well-being are taken into account by the government, whereas private management must confine its considerations to the profitability of the particular enterprise. Wasted savings are a crucial matter to the state, but of relative unimportance to the individual investor. In no small part the final answer to the question of debt potential will be related to the income yield of public investments; and any adverse effects on private income should of course be taken into account.

DEBT POTENTIAL

Having discussed briefly the effects of the process of accumulation of debt, we return to specific estimates of debt potential. Let us discuss now a figure which does not seem so fantastic as the assumed figure of $4,000 billion. A possible situation would be the following. According to the pattern of distribution of income in 1940, an income of $100 billion would be divided roughly as follows: $70 billion to wages, salaries, etc.; $18 billion to profits, rents, etc.; $12 billion to dividends, interest, etc. Taxes of $20 billion required to finance a debt of $800 billion (at a rate of interest of 2½ per cent) might be assessed as follows: $6 billion on wages, etc.; $6 billion on profits, etc.; and $8 billion on dividends, etc. This distribution of the burden is determined by the assumed need of reducing adverse effects on enterprise to a minimum. Is it then possible to carry a Federal public debt of $800 billion without a serious inflation?

A final answer depends on several other variables. If the non-debt tax burden is $20 billion, then a tax burden for the financing of the Federal public debt of $20 billion at a national income of $100 billion seems intolerable. The possibility of raising $40 billion in *Federal* taxes out of a national income of $100 billion is slim indeed even in wartimes. In peacetimes, the outside limit would be much lower. If the income is assumed to be $100 billion exclusive of the

[1] *Cf.* the essay by Prof. Hansen in this volume.

$20 billion of interest on public debt, then the prospects would seem to be somewhat more hopeful. Yet *total* taxes would constitute 33 per cent of the national income. A radical revision of our tax system would increase the possibilities of carrying this burden. Finally, a rise of national income associated with technological and organizational change and the increase of population, and all these possibly associated with public investment, would contribute to the attainment of a high national debt without disastrous effects on prices and output. As we can observe below, the crucial factors are the height of nondebt charges in the budget and the level of income. If income does not rise and if the burden of other charges continues to increase, as we assume here, a public debt of $800 billion will undoubtedly have serious effects.

Hypothetical cases are suggested in Table 2. The reader will observe that the ultimate size of the public debt will depend in no small part on the costs of nondebt governmental services. A much larger public debt is suggested under 1 than under 3 despite the fact that the total tax burden is much larger under 3 than under 1. In the latter case, however, tax charges (other than for debt servicing) are but 64 per cent of the charges assumed under 3. The country may well be able to carry a debt burden of $300 billion with an income of $100 billion if our tax system is overhauled and other demands on the Treasury are kept in check; and a fortiori if the

TABLE 2.—INCOME, TAXATION, AND PUBLIC DEBT
(In billions)

Case	National* income	Total taxes	Taxation exclusive of Federal debt	Taxation for debt financing	Public debt (assumption of a 2½ per cent rate of interest)
1	$100	$26	$14†	$12	$ 480
2	100	25	20‡	5	200
3	100	30	22	8	320
4	150	40	25	15	600
5	150	40	14	26	1040
6	150	75§	15	60	2400

* Assumptions: 1. Prices at 1942 level.
2. Rate of interest = 2½ per cent.

† The predefense figure.

‡ A more likely figure.

§ It is assumed here that the tax burden is $15 billion + ½($75B − 15B$) or $45 billion. Taxes for transfer purposes are assumed to be one half as burdensome as other taxes.

national income rises to $120 to $150 billion or more. At an income of $150 billion, the debt potential rises greatly in response to a reduction of nondebt charges, an increase of tax capacity and an allowance for the relative lightness of the burden imposed by transfer taxes.

An estimate of the rise of public debt under various assumptions (beginning with 1940) is given in my *Economics of Social Security*.[1] If debt should rise by the amount of the interest charge (*i.e.*, at compound interest and on the assumption of a rate of interest of 3 per cent), it would rise to $130 billion in 1980 and $230 billion in the year 2000, the respective interest charges then being $3.9 billion and $7 billion. (These estimates leave out of account the large rise of debt associated with the war. Professor Shoup had estimated that as a result of the war, the public debt will rise above $100 billion by 1943.[2]) In October, 1942, the anticipated debt for June, 1943, is $125 billion, and in June, 1944, the debt may well be $190 billion.

We have prepared a number of alternative estimates of the possible magnitude of the national debt at future dates under two general hypotheses concerning the behavior of future expenditures and revenue. Under the first hypothesis we assume that the expenditure of the Federal government (plus the interest charge) always exceeds the tax revenue by a constant amount. On the assumption of a rise of $2 billion annually, the national debt would rise to almost $120 billion in 1980 and $160 billion in the year 2000. A second set of estimates is based upon a different type of hypothesis. It is now assumed that total expenditures *exclusive* of interest charges exceed tax revenues by a constant amount. Expenditures are in excess of those under the first hypothesis by the amount of the interest charge. Rough calculations yield the following results on the assumption that the revenues fall short of the interest charge plus a constant amount indicated.

[1] *Op. cit.* pp. 273–77. *Cf.* B. Higgins and R. A. Musgrave, "Deficit Finance —The Case Examined," in *Public Policy* (ed. C. J. Friedrich and E. S. Mason, Cambridge, Mass., 1941), pp. 173–176. Their computations reveal that the rate of interest assumed makes a vast difference. They assume that, aside from interest costs, the debt will rise by $2.5 billion yearly. In the year 2050, the public debt would rise to (1) $320, (2) $1,490, and (3) $3,125 billion according as the interest charges are (1) tax-financed, (2) loan-financed with the rate of interest 2 per cent, and (3) loan-financed with a 3 per cent rate.

[2] *Cf.* C Shoup, *Federal Finances in the Coming Decade* (New York, 1941), p 24.

Year	Constant = $2 billion		Constant = $3 billion	
	Debt	Interest charge	Debt	Interest charge
1960	100	3	135	4.1
1980	200	6	275	8.2
2000	400	12	550	16.5

CONCLUSION

It may be a shock to many to learn that a public debt of $4,000 billion *may* be carried by the economy without a collapse of the capitalist system, a repudiation of the debt, or a great inflation. Yet the arithmetic of the problem suggests this conclusion. We assume a national income of $200 billion in 50 to 60 years plus $80 billion of interest on a public debt of $4,000 billion, the rate of interest being 2 per cent. These are not unreasonable assumptions. Avoidance of long periods of unemployment, a slightly rising price level, the anticipated increase of population, and a continued rate of technological progress substantially less than what we have become accustomed to in the last generation will assure the country an income (exclusive of interest on public debt) of $200 billion. That the total tax bill will then come to $80 billion plus an estimated $35 billion for nondebt purposes may be a source of anxiety to many. Taxes would then rise to 40 to 41 per cent of the national income. Since $80 billion will be for servicing of debt, however, the real burden is considerably less than is indicated by that figure. If taxes assessed for transfer are assumed to be one half as burdensome as taxes for other purposes, the ratio of taxes to income might be well within the limits of taxable capacity in peacetime. The charge for nontransfer purposes may be roughly put at $30 billion. After covering these charges, the nation is still left with $250 billion, of which $80 billion are taken for debt purposes and promptly transferred to the rentiers. Then $170 billion of income free of public charges remain. The real income per capita after taxes would be at a much higher level than before the Second World War. We may even be so optimistic as to suggest that the accumulation of debt may contribute to the attainment of the high income assumed in this discussion.

Not only the picture 50 years from now but also the transitional effects need to be considered. In the body of this paper, we have argued that a rise of debt of these proportions will not necessarily

be accompanied by a galloping inflation. The greatest danger lies in the war period, when employment is high, inflationary methods of finance difficult to avoid, and the level of governmental expenditures very high. In periods of unemployment, the rise of monetary demand is likely to bring an increase of output though moderate price rises are not excluded. As the economy approaches full employment and private outlets do not prove adequate, the accumulation of public debt should be accompanied by diversions of cash (savings) to the government and the construction and purchase of valuable assets. The government merely takes a larger part in investment activity, which in turn becomes of increasing importance relative to consumption. Public debt accumulates; public assets rise at an equal rate; and the increase of money is related to the rise of income, not of public debt.

Many political issues arise, and they cannot be brushed aside lightly. A large rise of debt brings a powerful rentier class. Other members of society will resent the payment of taxes to support this class in idleness and possibly in ostentatious consumption. The way out is, of course, to put heavy taxes on the holders of bonds, though the taxation should not be so heavy as to constitute confiscation. If the gross yield on bonds is 2 per cent, they might well be left net (after taxation) with 0.5 per cent, or possibly somewhat more.

Others will object to the increased activity of the government in the investment field. The reply to these critics is that public investment is accepted only because other alternatives fail. A revival of private enterprise—subject to increased public control—is a preferable way out. We hope that a public debt of $4,000 billion or even of $1,000 billion will not be necessary. In any case, the man in the street worries too much over a public debt of $100 to $200 billion.

CHAPTER XI

PROBLEMS OF PLANNING PUBLIC WORK

BENJAMIN HIGGINS

INTRODUCTION

Problems of economic policy do not end with the establishment of general principles, nor even with the setting up of an organization for putting these principles into effect. In this essay, we shall be concerned with economic problems that arose after an agency had been set up for the express purpose of planning public work for the postwar period, an agency whose sponsors and members took it for granted that public work has a large role to play in attaining full and efficient use of resources, and a better distribution of the product of these resources. The tangible product which this agency aimed to produce was a "shelf" of public work, including all goods and services paid for by government, in the form of programs for every state and local government in the country. These programs were to consist of work scheduled over (say) 6 years, plus a "reserve" of additional useful projects, based upon careful social and engineering planning and thorough economic and financial analysis. An organization was built up with a small central office to serve in an advisory capacity, and a field staff of over 600 persons to work directly with state and local governmental officials.[1]

[1] The agency was the Public Work Reserve, which was organized in the summer of 1941, and disbanded in the summer of 1942. According to the official statement, "The Public Work Reserve—an Introduction," the aims and objectives of the PWR were as follows:

1. To encourage and assist in listing the needs of each state and municipal government in the fields of public service and capital improvement.

2. To promote the policy of long-range planning of useful public services and of needed capital improvements on state, county, and local levels, so that programs of worth-while work will be available when needed.

3. To aid and encourage the governmental bodies in wisely programing for a period of years their services and improvements, on a priority basis of relative need and expediency.

4. To encourage and possibly assist in expediting the advance preparation

There was even substantial agreement among sponsors and members of the organization as to the nature of the economic situation for which plans were being made. During the war itself, the outstanding feature of our economic development would be increasing scarcity of certain types of labor and raw materials. These scarcities would be accompanied by rising money incomes and property values, which would be reflected in growing revenues for state and local governments. This combination of circumstances would lead to increasing pressure upon state and local governments to eliminate expenditures which do not contribute to the war effort and to make reductions in tax rates. After the victory, the most likely sequence of events would be as follows: in the months immediately following the armistice, serious excess capacity and unemployment will occur in some centers. The transition back to a peacetime economy, however, will be easier than the transition to a war economy has been, since meanwhile we have built up a larger capacity of our machine tools and dies industries, and businessmen will be better prepared for reconversion than they were for conversion. Provided localized transitional problems are overcome, the accumulated backlog of demand for durable consumers' goods, made effective by release of financial reserves in the form of defense bonds and other holdings, will provide the basis for a substantial, though temporary, private boom. As the postponed demand is satisfied, this special stimulus to private investment will dwindle away. We shall face

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of designs, plans, and specifications of such public improvements in order that they may be ready for accomplishment at the opportune time.

5. By so doing, to establish on a national scope a known reserve of useful public work which can be used to stabilize employment during periods of economic stress such as may be expected at the close of the present defense activity.

The Public Work Reserve operated within the Federal Works Agency, but with the cosponsorship of the National Resources Planning Board and with Work Projects Administration funds. This tetrahydrad organization proved its undoing. A struggle for control developed, in which the agency that established jurisdictional rights turned out to be the agency which had no funds to continue the project. At the time of writing (August, 1942), the National Resources Planning Board continues to collect 6-year programs of work to be financed entirely with Federal funds, and the Federal Works Agency is building up a species of "reserve," consisting of discards from its War Public Works program.

Needless to say, nothing in this chapter can be construed as a statement of official policy of the Public Work Reserve or any existing agency and responsibility for the views presented rests entirely with the author.

again the problem of inadequate investment outlets ensuing from our attainment of maturity as an economy.[1]

The formulation of a general public work policy to be followed by state and local governments is relatively simple. Governments should cut out all nonessential public work for the duration and place these items in a postwar "reserve," at the same time that they maintain tax rates and build up financial reserves, preferably in the form of defense bonds or cash. Such a policy will not only help us avoid postwar deflation; it will also contribute to prevention of wartime inflation.[2]

Given the stated objective, the forecast as to the nature of the economic situation, and the organization to carry out the accepted policy, it might seem easy to devise a public work program to meet the objective. Yet—quite apart from administrative, legal, and political problems—serious difficulties remain to be faced. The balance of this chapter is devoted to these difficulties, and particularly to those subject to economic analysis.

SOME STATISTICAL PROBLEMS

The first step in planning public work is to estimate the available supplies of labor and resources of various types, and the national income that could be achieved by full and efficient use of these resources. The next step is to estimate the extent of reallocation of resources and the resulting readjustments in the economy which will be necessary during and after the war. Third, the possible increase in private spending must be determined, taking into

[1] Those readers who are not familiar with the meaning and implications of "economic maturity" for a nation will find brief discussions in an essay by Benjamin Higgins and Richard Musgrave, "Deficit Finance—the Case Examined," *Public Policy* (ed., C. J. Friedrich and E. S. Mason, Cambridge, Mass., 1941), and in the book *An Economic Program for American Democracy*," by seven Harvard and Tufts economists (Cambridge, Mass., 1938). For a more detailed analysis, see Alvin H. Hansen, *Full Recovery or Stagnation* (Boston, 1938). [See also the essays by Profs. Hansen, Samuelson, and Sweezy in this volume.—EDITOR.]

[2] Such a program has already been adopted by the state of Minnesota and by a few cities and is being considered by the states of Massachusetts and Virginia. Other states are considering debt reduction. This latter policy is acceptable provided it is regarded as building up a credit reserve for postwar expansion, and not as a permanent policy of debt liquidation. Consideration might well be given to the issuing of special "municipal reserve bonds," which would be callable and returnable under stated conditions, in order to provide municipalities with flexible and legal reserves.

account the various types of stimuli to increased private spending which might be undertaken as part of an over-all economic policy.[1] This spending must then be translated into demand for labor and resources. Once this demand has been determined, the magnitude and nature of the demand for labor and resources to be provided by public work, directly or indirectly, can also be determined. Clearly, some statistical problems of the first order are involved in making such estimates.[2] But statistical operation of considerable magnitude still remains before the job of planning public work is finished. The estimated *need* for public work must be compared with the "shelf" which is being prepared, to see whether the "shelf" is providing the right volume, type, and location of employment. Since complete predictability is obviously out of the question, the determination of the need for public work is rather a matter of defining the range of sizes and types of public work programs that may be called for. The "shelf" must be big enough and flexible enough to meet any eventuality within the realm of reason.

The translation of a "shelf" of public work projects into labor and materials patterns must of necessity be based on past experience. Certain agencies, such as the Bureau of Labor Statistics, U. S. Soil Conservation Service, U. S. Forest Service, and the Federal Public Housing Agency, have developed "experience tables" showing the volume of employment provided by (say) $1 million of public work of various sorts. Unfortunately, serious gaps in these data exist, such as those relevant to airports and airways, parks, equipment purchases, and public services. These gaps must be filled. Moreover, in some cases the categories of work are too broad, as in public buildings, and the breakdown into labor types is inadequate in nearly all cases.

Even when satisfactory experience tables are available, the problem remains of obtaining from the field staff data in a form suitable for use. In general, this problem consists of assuring reasonable conformity of the data submitted to the data from which the labor and materials patterns were derived. Many problems of

[1] Among such measures are: subsidies or loans to private enterprise for the purpose of converting plant and equipment to peacetime production; provision of loan funds at low rates of interest; guaranty of minimum rates of return on investment in particular fields; social security payments to unemployed to maintain purchasing power; wage subsidies; etc.

[2] For the most part, such estimates were entrusted by PWR to other agencies.

definition arise. For example, even so simple a concept as "cost" of a project needs accurate definition. Should cost be based upon current wages and prices, or upon expected wages and prices, or upon wages and prices as they existed at the time when the experience tables were derived? Do the estimates submitted for "construction costs" run in terms of "force account" or "contract" methods of accounting?[1] Should mechanical installation, functional equipment, cost of installation be included in construction costs?

The general criterion which was adopted by the Public Work Reserve was, naturally, that cost should be defined in such a method that existing experience tables could be used. Unfortunately, there is wide variation in the concept of costs employed in experience tables. Thus, in the case of public buildings, mechanical equipment only is regarded as part of construction costs, since that was the practice of the Public Works Administration on such projects. On the other hand, "costs" for public housing projects must be defined to include also equipment installed and the cost of land acquisition, since the experience tables of the Federal Public Housing Agency are based upon total development costs. In the case of power plants, "construction costs" include virtually all equipment. The divergences between definition of costs by different agencies from whom experience tables must be obtained make instructions to the field staff with respect to the definition of cost extremely difficult to devise.

Another problem of definition which had to be tackled by the Public Work Reserve was the definition of a "unit" of public work.[2] A unit might be defined as the smallest job that could be undertaken from a technical point of view, the smallest size of project which would be useful, the standard contract unit, or the job which is likely to be done all at the same time. The Public Work Reserve finally adopted a hybrid criterion involving all these concepts.

The definition of off-site labor involves a combination of statistical and conceptual problems. The main question is where to stop.

[1] The chief differences in the two types of estimates are as follows:

1. "Force account" costs include no profits.

2. The figures of the Bureau of Labor Statistics for "contract" costs do not include "user cost" on old equipment in deriving labor and materials patterns.

[2] The problem arose in connection with the efforts of one state office to make a good showing on the number of proposals submitted, by dividing work into infinitesimal units.

One may stop at the amount of labor required to produce raw materials used on the site. Or the share of the labor which is used to produce equipment operated on the site and which can be allocated to that particular project may be included; if this is done, the method of apportionment requires consideration. Should total unit or marginal costs be considered? Should labor employed in producing the equipment that is used in producing the raw materials on the site be included? Obviously, unless a clear-cut line is drawn the entire volume of employment may eventually be regarded as the off-site employment of any project.[1] There would be considerable advantage in abandoning the concept of off-site employment and substituting for it the more accurate concept of "leverage."[2] However, the statistical problems of measuring leverage are much weightier than the statistical measurement of off-site employment, once it has been defined.

SOME ANALYTICAL PROBLEMS

Even with the general principle established that public work should be used to combat postwar depressions, analytical questions arise. For one thing, analysis of the relation of public work spending to "full employment" in the transition period will differ radically from the analysis which was applicable during the thirties, since at the beginning of the transition period full employment will already prevail. Accordingly, if government policy is successful in maintaining full employment, and at the same time avoiding monetary inflation, it means that "leverage analysis" in the ordinary sense has no relevance to the determination of what that successful policy would be; if full employment is maintained at all times, no second-

[1] In the *Economic Effects of Federal Public Works Expenditures* (National Resources Planning Board, 1940), Kenneth Galbraith included only labor used to produce raw materials used on the site of construction projects. Galbraith admitted the conceptual deficiencies in this definition, but balked at the difficulties of allocating overhead costs. Public Work Reserve planned to estimate the volume of employment provided by equipment installed in projects, or by purchases of new equipment by state and local governments, but abandoned as hopeless the effort to get patterns for equipment used in construction. Another problem ignored by Galbraith is the possible negative effects upon employment of particular projects.

[2] *I.e.*, the coefficient relating the total rise in income (or employment) resulting from public work to the initial rise. For a definition and summary analysis of this concept, see Higgins and Musgrave, *op. cit.* pp. 137–142 and 164–172. For a thorough exposition, see Alvin Hansen, *Fiscal Policy and Business Cycles* (New York, 1941).

ary effects upon employment can take place.[1] In a way, this fact simplifies analysis; the problem is merely one of replacing one form of spending with another.

The assumption that the economy will not be geared irreparably to an increasing rate of consumption seems reasonably safe. It is unlikely that there will be substantial net investment during the last years of the war. Total consumption, including both military and civilian consumption, will have been increasing at a slow and fairly constant rate; for with full employment achieved, and new investment in isolated sectors of the economy offset by capital consumption elsewhere, total consumption can increase only so fast as technique improves. Any reactions to a declining rate of increase in consumption will probably have already taken place, and will have been offset by the continuation of a high rate of government spending. The "acceleration principle" proper, and probably the "relation" as well,[2] operates only at the stage of an upswing where there is insufficient excess capacity in the relevant capital goods industries to meet the anticipated increase in demand for the final product, but where there is still unemployment of labor and raw materials. By the end of the war, we shall probably have passed that point so long ago that adverse effects of failure to maintain a given *rate of increase* in consumption need no longer be expected.[3] Accordingly, the problem of devising a full employment policy will be a relatively simple one.

The economy will be in the situation of having reached full employment through government spending, so that any reduction in government spending, not offset by an equal increase in private spending, will tend to result in a relapse of national income and employment to the "starting point." If we can regard 1932 as an equilibrium starting point, the slightest uncompensated reduction in government spending could lead to an ultimate reversion of

[1] There are, of course, "disguised" secondary effects of public spending even when full employment prevails; *i.e.*, an uncompensated *decline* in public spending will lead to a more than equal *decline* in income and employment; and an uncompensated *increase* may lead to a cumulative inflation.

[2] The "acceleration principle" relates increases in investment in a particular industry to increases in demand for its product. The "relation" covers consequent expansion of investment both in the industry whose demand has increased and in other industries. *Cf.* Higgins and Musgrave, *op. cit.*, pp. 138–141.

[3] However, *if* the war were to end in the next few months, these adverse effects might still be quite serious.

national income to the 1932 level, or lower. For just as people do not increase their consumption by the full amount of an increase in their incomes, so they do not reduce their *savings* by the full amount of a decline in their incomes. If the government reduces its rate of spending by $100 per month, income falls, not just by $100, but by $100 plus savings. The ultimate decline, owing to the process of contraction of consumer spending which results from reduced government expenditure, will be a multiple of the original decline. This contraction of consumer spending tends to produce a secondary fall in private investment, which reduces incomes still further. Consumer spending again contracts, national income falls by a multiple of this contraction, investment falls accordingly, etc. If we assume constant "multiplier" and "relation" coefficients, this process tends to "peter out" in the neighborhood of the "starting point." In reality, once the process becomes cumulative, national income may plunge still lower.

Many people feel that a postwar decline in income is inevitable if we are to have a "sound recovery." The war must be "paid for" by depression. We must all pull in our belts and suffer, until the plant and equipment built up for war purposes has been liquidated, and we are ready to begin building anew for prosperity. These people can even find support for such an idea in economic literature.[1]

However, there is no reason why liquidation of investment in purely wartime plants cannot be accomplished just as well with a high national income as with a low one. Provided the general level of interest rates is prevented from rising too high by appropriate monetary and fiscal policy, it will be the relative and not the absolute level of profits which will determine whether or not any particular type of plant will be maintained. Purely wartime industries will be unable to compete for resources with peacetime indus-

[1] Particularly in the trade-cycle theories of Ludwig v. Mises and Friedrich v. Hayek. According to these economists, a boom consists of a "lengthening of the period of investment," which develops a capital structure that cannot be maintained when the artificial stimulus of inflation is removed; and the downswing is a necessary process of liquidation of this capital structure. Only after this process is completed, they maintain, can there be a sound recovery. Although a war period is inflationary in many respects, it probably is not inflationary in the Hayekian sense; *i.e.*, the proportion of resources devoted to the production of capital goods, as compared to production of final products, is unlikely to increase. The problem is rather one of substituting one kind of final production for another, without any substantial revision in the length of the period of investment.

tries, once the need for their products is a thing of the past. Deflation merely to provide for liquidation of capital which proves "malinvested" in the light of changed conditions represents a quite unnecessary self-impoverishment. Moreover, there is always the danger that a downswing will be cumulative, and go beyond the point of economic and political safety. Professor Hansen has estimated the cost of underemployment during the thirties at $200 billion; we cannot afford such a mistake again.[1]

There is a quite different and more formidable danger lurking in the reconversion process. If American industry is unable to return to production of peacetime goods as fast as the American people want to buy them, we may have a serious postwar inflation. In order to safeguard the economy against this threat, it will probably be necessary to retain price controls, high tax rates, rationing, and other anti-inflation devices, for some time after peace is declared. The Mises-Hayek thesis does teach us, however, that support of the *particular* structure of production with which we end the war may be unwise, since we might thereby prevent or delay transition to a peacetime economy more in conformity with our peacetime wants.

One of the most important questions with respect to public work policy is going to be the desirability of "neutrality" in a public work program; *i.e.*, the decision must be made whether public work should be used to prevent a tendency toward migration of industries and populations, to accelerate such adjustments, or to remain neutral with respect to them. My own attitude is that public work ought not to be used to stabilize uneconomic situations. Work relief may be necessary to meet emergency conditions; it ought not to be used to "freeze" workers in localities where long-run prospects of employment are poor. Since the location of defense industries has not been determined entirely in accordance with the long-run factors

[1] Alvin H. Hansen, *After the War—Full Employment* (National Resources Planning Board, 1942). It might still be asked whether the "Hayekian paradox" may not arise in the immediate postwar period. May we not have a high demand for consumption goods, combined with a capital structure which is inadequate for the production of these goods? At worst, this situation is serious only if it is allowed to give rise to a cumulative downswing. Any such tendency can be prevented by government intervention. Moreover, it seems likely that Prof. Hayek, however rigorous his economic analysis in terms of the assumptions he makes, is unrealistic in his assumptions with respect to engineering problems. The difficulties of converting existing plant and equipment to other types of production are probably overestimated in his analysis.

that are operating, a considerable amount of migration is likely to take place unless specifically prevented by public policy.

At least two types of policy, which might be called public work, suggest themselves. First, the retraining program should be retained as a permanent part of a public work program. Retraining will be necessary not only during the transition period, but whenever the appearance of new industries makes necessary a shift of workers from one industry to another, including a shift from public work into new industry. As new industries reach maturity, a reverse shift from these industries to public work may be necessary. The need for retraining to meet such changes is a recurrent one. The occupational mobility which this type of program could provide should be supplemented by a government program to provide physical mobility. This plan might take the form of making available to employment offices information with respect to vacancies in other centers, with provision by the Federal government of travel vouchers for workers moving from one place to another, to take bona fide positions which promise some hope of permanency. Such a program would do much, incidentally, to solve the problems that will face American railways.

The determination of the proper geographical distribution of public work clearly requires an enormous amount of economic analysis. In general, the way in which public work could be used to stimulate adjustment to economic trends is clear enough. For example, in decadent communities, such as some of the New England textile, shoe, pulp, and paper towns, blighted areas should be destroyed and converted not into housing projects but into parks or similar public facilities. New housing projects should be built in expanding communities. The same plan applies in general to other types of public work. By distributing public work funds along these lines, pressure is applied to labor and to capital to overcome the inertia that prevents migration to localities where productivity is high. If a public work policy is combined with policies making the migration easy, a much more flexible economic system can be developed.

PROBLEMS OF TIMING AND "TELESCOPING"

In the literature on the economics of planning public work, considerable attention has been devoted to problems of timing. Difficult as the analytical problems of timing are, the most serious

questions of this sort which confronted the Public Work Reserve were "operational" ones. Having decided on a conceptual plane what the proper timing of a public work program would be for the economic situation faced, one must still find out how the impact of the projects at his disposal will be distributed through time. If the time pattern available does not fit the time pattern wanted, some means of revising or supplementing the programs in the "shelf" must be found.

Time patterns based on the experience of the Public Works Administration exist for construction projects, and they may be applied to comparable cost projects which are submitted to the reserve. There is always the possibility, of course, that the construction techniques actually used will be different from those used on PWA; but where differences in techniques are subject to control, as in the Work Progress Administration regulations, no serious problem arises. There may be a divergence between "duration" of a project in the fiscal sense and in the engineering sense. Surveys, construction, and operation, instead of following each other in neat chronological order, may possibly overlap. For example, the additional school teachers for a new school may be hired and used in existing buildings before construction of the new building actually begins; in this case, maintenance and operations costs start before construction costs. Estimates of the duration of projects may be upset by the necessity of drawing on the same pool of labor for many projects, so that an attempt at simultaneous operation will reveal scarcities of *some* types of labor and will result in unexpected delays.

So far as the postwar transition is concerned, what is particularly needed is a reserve of projects of the noncontinuous and nonconstruction type. Such projects are not only easy to start but are also easy to stop. The volume of public work expenditure in particular localities immediately after the war may be quite high. Conceivably, the volume of work needed will exceed the existing capacity of the construction industry in the localities concerned. Since the size of the public work program that is needed dwindles as private enterprise accomplishes its reconversion, programs which require occupational or geographical shifts of labor and of capital goods should be undertaken only where the long-run prospects of private enterprise require a similar shift. We do not want to retrain men for public work, and then have to retrain them again for private enterprise after a few months.

Unfortunately, because of the grooves in which state and local officials tend to think about public work, projects of the noncontinuous and nonconstruction type are difficult to obtain. The great bulk of projects submitted to PWA fell into a few categories of construction work—highways, roads and streets, waterworks, sewers, public buildings, housing, and soil conservation.[1] Moreover, the amount of employment that can be provided by noncontinuous public service projects seems to be very small. The average number of employees on such projects, as indicated by the small number that were submitted to the Public Work Reserve, does not seem to be much above ten.

Public work projects devised by state and local governments are for the most part of relatively short duration: the average duration is less than 6 months, and nearly 90 per cent of the projects seem to take less than a year to complete. A "shelf" of such projects would appear to provide a high degree of flexibility. The difficulty is, however, that while *construction* may be completed before the end of the transition period, maintenance and operation costs will

[1] The percentage distribution by type of the first 18,000 projects submitted to the Public Work Reserve was as follows:

Type of project	Selected project types as percentage of all projects			Construction cost as percentage of total cost
	No. of proposals	Total cost	Construction cost	
All projects	100.0	100.0	100.0	80.9
1. Highways, roads and streets	15.2	19.0	18.1	77.1
2. Public buildings	32.8	13.8	14.2	82.9
3. Water works	8.2	6.7	7.2	86.4
4. Sewers	11.6	11.9	13.6	92.6
5. Low-cost housing construction	0.7	12.0	10.2	68.9
6. Power production	0.3	0.9	0.5	47.7
7. Land conservation and development	2.3	5.0	5.0	81.9
8. Forest protection and improvement	3.5	0.9	1.1	90.9
9. Parks	4.4	5.9	5.1	70.6
10. Airports and airways	1.0	2.7	2.6	78.1
11. All other	20.0	21.2	22.4	85.6

continue beyond. The private boom will be "damped" by competition for labor and resources from the public sector of the economy, for the purpose of maintaining and operating capital improvements. No doubt, in many cases use of resources by the public sector of the economy will contribute more to economic welfare than any alternative use of the same resources in the private sector; but we must distinguish between undertaking public work for its own sake and for the purpose of maintaining employment and income.

At the beginning of a construction program, maintenance, operation, and replacement costs seem such small items relative to the original construction costs that their economic significance might easily be overlooked. Yet with a constant rate of total expenditure on capital improvements, the proportion of these continuing costs to the total will increase until continuing costs absorb the entire outlay. It is quite conceivable that the economic impact of expenditures for maintenance and operation, and the distribution of funds withdrawn for replacement, may in certain periods exceed in importance the impact of new construction. This situation will prevail particularly in periods when construction is tapering off and when continuing costs may still be rising. Thus, for a purely transitional problem, the public work program should not include too many projects with heavy continuing costs.

On the other hand, since the private investment boom cannot be expected to last indefinitely, some "sustaining projects" of a type that require large-scale government investment should be included in the reserve, to be executed whenever the need arises. Such projects for the most part do not originate from state and local governments; the average cost of the capital improvements project submitted to the Public Work Reserve was under $250,000. State and local public work programs, therefore, must be bolstered by large-scale Federal projects.

One of the most pressing problems connected with timing is essentially a political one. Over 80 per cent of the projects submitted to PWR required plans and surveys prior to their execution. The average time required for these plans and surveys was over 2 months. Failure to make the needed plans and surveys *during the war period itself*, therefore, may involve disastrous delay in launching the program. A 2-month lag may be sufficient to let a cumulative downswing start. All that is required to make these plans and surveys is a few hundreds of thousands of dollars; let us hope

that Congress will recognize the false economy of failure to provide the necessary funds.

Other problems of timing arise out of unestimable delays: delays due to legal complications, difficulties of acquiring sites, etc., are hard even to foresee, let alone calculate. For this very reason, it is important that as much as possible of the legal and other preliminaries be completed now.

Planning public work involves the concept of "telescoping"—concentrating the work of several years into a short period to provide employment. This process provides problems of its own. Let us suppose that we have "6-year programs" from all states and all significant cities, consisting of work for which appropriations have been made for the next budget year, of work scheduled for the 5 following years, and of a reserve of projects that are desired but for which funds are not available at the present time. Let us also assume that these programs are revised annually, so that on the day of the armistice we have a "shelf" of up-to-date programs. Finally, we shall assume that the "transition" is expected to last only 1 "year"[1] and that all the work is to be done in that time. How much employment can be provided during that year by using this "shelf" as a basis for Federally financed public work?

Let the employment provided by public work during the current fiscal year be n_0, employment provided by the work scheduled for each of the subsequent fiscal years in the program taken by itself, be $n_1 \ldots n_5$, and the work provided by the "reserve" be n_6. The net increase in employment which might be provided by the "shelf" in a single "year" is then $N = (n_1 + n_2 + \cdots + n_6) - n_0 - L$, where L is the "leakage" due to the following factors:

1. Some of the projects may take more than 1 "year" to complete and would therefore extend beyond the transition period. The calculation of the volume of such projects, and their elimination from the "shelf," is a simple process.

2. Initiation of some projects planned for 1 year may be dependent upon the partial or total completion of projects planned for previous years. Accordingly, the whole "shelf" may not be available in 1 "year." Information about this kind of interdependence is essential if accurate estimates of the impact of the "shelf" are to be made.

3. Some of the projects in the "reserve" may be *substitutes* for projects scheduled. The relegation of these projects to the

[1] This "year" might be any limited period without changing the argument.

"reserve" may be preferred *if* Federal aid is forthcoming, but cheaper and less satisfactory projects must be undertaken if the local government is dependent upon its own resources; *i.e.*, "n_6" may be substitutable for, but not additional to, parts of "$n_1 \ldots n_5$." When such a relation exists, therefore, it should be clearly indicated.

4. The undertaking of some projects in the program may *require* the undertaking of other projects which, through imperfect planning, were not programed. With limited funds, such a situation would require substitution of unprogramed projects for programed ones. Thus the *content* of the program may be changed. This problem can be eliminated by adequate foresight and planning.

5. Costs, and labor and materials patterns which are implicit in costs, will be functions of the *scale* of operations undertaken at one time. Thus, even if the existing patterns were applicable for each year taken by itself, they would be wrong for a "telescoped" program.

If something less than the total "shelf" is used—as seems probable—additional problems arise. Not only the dependence of initiation of one project upon total or partial completion of others must be considered, but also the dependence of the initiation of one project upon the initiation of others. Some projects must be executed simultaneously. Here again, accurate analysis of the impact of the program that will finally be put into operation requires knowledge of this interdependence.

The question also arises, if only part of the complete "shelf" is used, whether the scheduled program or the "reserve" should be "telescoped." The scheduled projects presumably constitute the preferred projects for the most part, although the "reserve" may contain projects postponed merely because of their cost or because the need is not pressing at the moment. On the other hand, the scheduled projects will presumably be carried through in any case, so that Federal funds might best be devoted to the "reserve." It seems clear, however, that in so far as public work is used for the express purpose of smoothing a transition, an evaluation of *projects* in terms of "process effects," which might be quite different from evaluation in terms of "product effects," should be available and used. Precision with respect to the impact of particular projects cannot be obtained. A ranking of projects in terms of the general order of magnitude of their "process effects" would suffice. Each project might be assigned a priority rating in such terms.

SOME STATE AND LOCAL PROBLEMS

The situation with respect to expansion of public work expenditures by a single city is much like expansion of credit by a single bank; "leakages" to other cities (or banks) will be high. "Multiplier" effects for a city expanding alone will be reduced by the large proportion of new income spent on "imports"; "relation" effects may be felt entirely outside the community. Yet, as with expansion of credit by all banks, when all cities expand public work expenditures together, the "leakages" tend to neutralize each other and an over-all expansion results.

Nevertheless, it is not a matter of indifference for the national economy as a whole *where* the reactions from a particular project will be felt. Some knowledge of the "geographic multiplier," as someone has called (somewhat loosely) the response in one place to spending in another, is essential to careful planning of public work. Given the "materials pattern" for any project or program, plus knowledge of the location of industries producing these materials and of the firms from which the city government normally buys, some approximation to this "geographic multiplier" can be made.

The chief problems on the state and local level are, however, fiscal. Even where a strong financial position prevails, legal, political, and psychological barriers against accumulation of reserves in boom periods and expansion of debt in depression periods complicate the public work planner's operations. Among the first complete programs prepared through the PWR, there was almost an universal acceptance of freedom from debt as the single end of municipal finance. The idea that state and local governments have an obligation to avoid, wherever possible, fiscal policies which run counter to Federal fiscal policy, is quite foreign to most state and local officials. To teach state and local officials that the margin between anticipated current income and outgo represents, not the total size of public work programs that can be undertaken, but the outside limit to the amount that can be safely devoted to servicing increased debt, is itself a surprisingly difficult task. To teach them to regard debt as simply the other side of the balance sheet from municipal *assets* is another. A true understanding of the meaning and significance of governmental debt and of the general principles of over-all fiscal policy is essential to true "sound finance" on the municipal level.

By no means all states and cities are financially strong. Many of the older cities are typified by, say, San Antonio, Tex. The

population is still increasing, but the increase is taking place in the Mexican quarter, where 93 per cent of the people have incomes under $1,550 annually. Thus the increase in population brings new expenses but no new revenue. Meanwhile, the wealthier residents have moved outside the city limits, escaping property taxes and leaving blighted areas behind them. Other cities are suffering less from decadence than from past extravagance. Nearly any city in Florida would serve as an example. In the boom days of the twenties, state and city alike plunged cheerfully into debt. The state offered special inducements to residents in the form of low property tax rates, very high exemptions, and absence of income and property taxes and thus sadly impaired its revenue-raising capacities. During the depression, "taxpayers' strikes" left many cities with no revenues whatsoever, and overdue municipal bonds selling on the market for, say, $20 were accepted at par in lieu of taxes. Worried citizens prevailed upon their representatives in the state legislature to have their neighborhood, consisting sometimes of less than 100 people, removed from the city limits and separately incorporated; thus the city's revenue potentialities were reduced further. Miami, for example, has a sum available for debt service running currently at about $300,000 annually. This sum would service safely a permanent debt of $3 or $4 million; the actual debt is close to $30 million.

Where such conditions prevail, there is only one way in which an expanded public work program can be undertaken—*i.e.*, through Federal grants. It is even doubtful whether a contributory system will permit participation of all communities; but this subject belongs to another essay.[1]

SUMMARY AND CONCLUSIONS

In this paper, we have outlined some practical economic problems of planning public work; "practical," because they arise from an attempt to apply widely accepted economic principles in the execution of a stated policy, as distinct from the attempt to develop new principles or to formulate a new policy. We have limited the discussion to problems associated with the collection and analysis of a "shelf" of projects to help in meeting difficulties of postwar readjustment.

Successful operation of such a project requires first of all a rational limitation of the range of situations which the "shelf" may

[1] See Harvey S. Perloff, "Fiscal Policy at the State and Local Levels," in this volume.

be called upon to meet. We argued that at the war's end we shall probably have "full employment," and a relatively stable ratio of consumption to investment; the job to be done by public work will consist mainly of replacing war expenditure with useful peacetime expenditure to the extent that private outlays are inadequate. However, the "shelf" should be big enough and varied enough to meet any reasonably possible situation.

During the transition period itself, we contended, there will be a need for highly flexible projects, which can be quickly started and quickly completed as the incipient "spontaneous" boom gets under way. Price controls should be retained at the same time that support is given by public work spending, since there will exist simultaneously a danger of inflation and of deflation. Public work planning should not be abandoned once prosperity is upon us, for this prosperity will not last forever unless sustained by proper economic policy.

As the "shelf" is accumulated and revised, it must be constantly tested for adequacy of its probable impact upon the economy. Are the projects of the right type, size, and locality to provide, directly or indirectly, a demand for labor and materials when, where, and of the sort required for stabilizing national income at its peak?[1]

Such a test requires study of the economic geography and history of the various regions and localities of the country; it requires the development of labor and materials patterns for converting dollars to be spent on various kinds of public work into man-hours of employment and tons of materials; it requires preparation of instructions for the field staff preparing the project forms which will guarantee acquisition of necessary data in usable form. In

[1] In less than a year's operations, the Public Work Reserve accumulated a "shelf" of about 25,000 projects, constituting some $6 billion of public work, exclusive of New York City. This volume of work would provide approximately one year's work for 3 million men. However, constant revision is of the very essence of public work planning; programs developed last year will be of little use by the end of the war. Also, the geographic coverage was limited, and not in close accord with probable postwar needs. As pointed out above, too large a proportion of the dollar value was concentrated in five categories of capital improvement projects. The number of housing projects fell far below anticipated postwar needs. A much wider range of projects is needed to provide a safe degree of flexibility. Six billion dollars' worth of work *of the right kind*, properly analyzed and translated into plans and specifications, might possibly suffice for the transition period; but the public investment already sunk in the Public Work Reserve will be largely wasted unless the job is carried through to completion.

order to make the "shelf" operable, working plans and specifications should be prepared.[1]

The most significant "conclusion" of the paper is this: that the maxim "in time of *war*, prepare for peace" applies with special force to planning public work. The development of an adequate "reserve" of public work for the postwar period is neither a simple task nor one which can be accomplished quickly after the war is won. The inevitable lag involved in setting up an organization to do the job when the need for a public work program is already upon us may well be disastrous. Either we would be forced to resort once more to "boondoggling," or we would waste precious months developing an adequate public work program and run the risk of a cumulative downswing starting in the meantime. Either alternative is dangerous. Unless work is adapted to genuine needs, popular disgust with public work which is clearly of very little direct use may forestall the execution of a program on the requisite scale. The social effects of work that commands no respect even from the person doing it are as bad as, if not worse than, those of a straightforward dole. Yet to let a deflation start would be still more dangerous; its end may well be revolution.

Specific steps that must be taken in the immediate future are the following:

1. An adequate organization must be set up to plan public work for the postwar period and provided with enough funds to do the job thoroughly. A sum equal to the cost to the government of a price rise of 0.1 per cent would be ample—a small enough insurance premium for postwar security.

2. This organization must either be empowered to carry out the program after the war, or it must be an organization that the operating agency respects; otherwise, the plans will not be utilized and the work will be wasted.

3. Meanwhile, the necessary statistical research for efficient operation of this organization should be continued in those agencies, such as the Bureau of Labor Statistics, whose function it is.

4. Plans for a Federal grant-in-aid system should be drafted, and future grants should be attached to adequate planning during the war period.

[1] The New York City government, which has a keen realization of the importance of this type of "practical" postwar planning, has appropriated over ten times as much money for this purpose as was spent by the Public Work Reserve for the whole country.

Chapter XII

CITY REPLANNING AND REBUILDING[1]

Guy Greer

Primarily because of the misuse of land, our cities and towns are menacing the civic health of the nation. Like trees decaying at the core but spreading their branches wider and wider, they have fallen into a situation that is becoming intolerable, and their predicament is becoming progressively worse. Misuse of land, mainly by past generations, is indeed the underlying cause; but this cannot be dismissed as merely a case of the sins of the fathers. It is, rather, a matter of failure to foresee the consequences of eminently respectable attitudes and business practices projected into an era of rapid and profound changes in the technology of our society—attitudes and practices which we ourselves thus far have barely begun to alter. More specifically, the plight of the urban communities has resulted from the lack of planning and collective control of their physical development in the public interest. On the fuzzy-minded but comfortable assumption that, in the use of urban land as well as in almost everything else, economic action motivated by virtually unbridled self-interest would always promote the public interest, the cities and towns have been allowed to drift into their present sorry state.

There have been, to be sure, warnings. More than 50 years ago Ebenezer Howard began to cry out against what he saw happening. And from his day to ours, voices clear and strong have been lifted up, notably in the writings of the still young and vigorous Lewis Mumford. But for the most part we have closed our ears. To let go of our fuzzy-minded assumptions has seemed too painful for endurance.

Now, however, along with being forced to reexamine the foundations of the economic community from other points of view, we are obliged to face up to the consequences of the lack of planning and control of the use of the land in the towns and cities. And now it is

[1] Reprinted, by permission, from *The Journal of Land and Public Utility Economics* of August, 1942.

not only the philosophers and poets who are aroused, but the solidest of the solid men and institutions of business as well. Banks, life insurance companies, property owners, real estate dealers, not to mention social scientists and the public officials and others charged with responsibility for municipal finances, are becoming acutely aware of what has been going on. They see, among other things, that the people themselves—gropingly and usually with no more collective control than before—have been taking advantage of rapid transit in general and of the automobile in particular, to try to escape from the overcrowding and congestion of the interior of the towns. But the escape has been only partial at best, for the people have to come back into the towns to work; and meanwhile the congestion, if not the overcrowding, is made worse instead of better. The result is the dismally familiar story of the spread of blighted areas and slums.

Such areas have grown until in many communities they now cover from a quarter to half of the land within the city limits. And they are still growing. Most of them have been overzoned for business uses, and consequently the valuations placed upon them, and maintained for purposes of tax assessment, are so high that any attempt by private enterprise to buy them and redevelop them in traditional fashion would be fatally handicapped by financial charges from the start. The cities themselves are helpless, both because of their precarious fiscal position and on account of their lack of adequate legal powers from the states in which they are located; and they seem destined to remain so, unless and until their problem is tackled on a vastly wider scale than anything ever applied to them heretofore. It is the major thesis of this chapter that their predicament must be dealt with—just as soon as the war emergency will permit—as a great national problem.

THE APPROACH TO REPLANNING

Let us suppose that hereafter the nation will be able to think and act as would a well-run family estate. This is a big assumption, to be sure; but we are obliged to start from some such premise, else we can hardly hope even to survive the war, much less afterward to organize and maintain the peace. How, then, shall we set about dealing with the problem of the towns and cities?

In the first place, we shall have to undertake an immense job of economic and social research, preliminary to the job of replanning

and rebuilding. Each urban community, large or small, must of course replan itself; but it must do so in the light of what is to be planned for—in relation to its immediate surroundings, to other communities, to its state or region, and to the country as a whole. Its future size and importance must be estimated, and manifestly the assumptions made in this regard will have to be reviewed and verified by one or more larger units of government—perhaps the Federal government. Then for each community there must be gathered and analyzed the facts—not generalizations such as those in this discussion—about the blighted areas and slums, the land valuations, the housing conditions, the fiscal position of the town, the space requirements to relieve overcrowding and traffic congestion, the space requirements of all the various uses of the land, and so on and so forth.

When all this is done, the time will have come to begin the job of replanning. And while each community must make its own master plan as well as its plans for detailed redevelopment, each must—if we would avoid the errors of the past—abide by certain very clear, if only general, principles. These, as expressed by numerous writers on the subject, I have attempted to formulate in the language of the social sciences as follows:

1. The towns and cities must be planned and built, or replanned and rebuilt, for the health and happiness as well as the economic well-being of those who live and work in them. This is the first great commandment in city planning; and the second is like unto it.

2. The physical layout and the administration of the government, including the location of and the optimum balance among dwellings, business and industry, public services and facilities, must be such as to provide for the maximum possible ease in carrying on the basic activity of the people—making a living.

3. In the interior of the urban community there must be elbow room—plenty of it—both for the purpose of present living and working and for the necessary space to adapt the physical layout to the changes required or desired in the future.

4. Internal transportation must be so organized as to permit fast and pleasant movement of things and people whenever such movement is required or desired; but the location of business and industry, as well as all other points of assembly or contact, must be so arranged with relation to the dwellings of the people that movement which is required, though not desired, shall be kept at the lowest possible minimum, not forgetting that within reasonable

limits and in wholesome surroundings, the pleasantest as well as the healthiest form of movement for people is walking.

5. There must be in, or within easy access of, every urban community, not only all the public services needful for the physical and intellectual well-being of the inhabitants, but those required for their emotional well-being as well: as many of the cultural and spiritual facilities as the community can afford or the people can be induced to support—not only the utmost in educational opportunities for every citizen of every age, but art galleries, theaters, music, recreation centers, playgrounds, woods and streams for hunting and fishing, etc.

6. The towns and cities must, each in its fashion, be beautiful; but the beauty of each must be the expression of its own living, not a thing imposed from without.

What is to prevent us, after the war, from replanning and rebuilding our towns and cities in conformity with these principles? We shall have the most highly developed productive organization in our history. Once we have taken up the slack in producing goods for consumption, and have reconverted our plant and equipment to peacetime uses and made repairs and replacements, we shall almost certainly have available the man power and materials to undertake the rebuilding job. Indeed, if we may judge from the past, large portions of our resources would be wasted if we did not. Then why not?

There are certain obstacles in the way, although they are readily removable if we mean business. The most obvious one has to do with money and debt, or rather with our traditional notions about them. I shall give a little attention to them later on. There are two others, however, which already have been mentioned and will be discussed here.

LEGAL POWERS

First is the lack of adequate legal powers by the local governments to control the use of the land in the urbanized areas. Manifestly such powers will have to be granted them by the states. Specifically, the government (or governments—since frequently there are more than one) of the entire metropolitan area should be given the power:

1. To define (in agreement with the governments affected) the area to be planned.

2. To set up planning machinery and provide for the making of a master plan for the urbanized area, which in addition to the necessary maps and charts shall include a method of systematic procedure for its own future revision to meet the changing economic and social needs of the community.

3. To vest the planning agency with all authority necessary to formulate and keep up to date the master plan.

4. To define "public purpose" to include any purpose deemed by the appropriate agency of government within the urbanized area to be essential for realization of the master plan.

5. To acquire, by condemnation when necessary, land anywhere within the urbanized area for a public purpose as above defined; to hold, use, lease, sell, or exchange such land; and in any case to make certain that it shall be used only in accordance with the master plan.

6. To enact and enforce ordinances requiring the owners of real property within the urbanized area to use it or to permit its use only in accordance with the master plan.

In addition to the passage of laws such as these, the states should of course simplify and standardize the procedure of using eminent domain to acquire land. Manifestly, too, the courts should rule thereafter in accordance with the spirit and intent of the new laws rather than the precedents set up under the conditions to be remedied. The indispensable requirement now is for what in America may seem a wide departure from traditional concepts of land ownership and control, although it would mean merely the adoption of concepts long established in the best governed countries and cities of Europe.

How can the towns and cities get this sort of legal status? The answer is not so simple as one might wish. A number of things will be necessary. In the first place the local communities themselves must become aroused to the nature and seriousness of the problem, then convinced that it is not hopeless of solution. The average citizen seems to know little or nothing about it; but if he *should* happen to try to visualize what would be involved in a solution of the problem, he is likely to take one look at the magnitude of the job and dismiss it from his thoughts as impossible of accomplishment. This state of public opinion will have to be changed. When it is, pressures will develop for the kind of legislation required.

But the state legislatures are usually dominated by rural rather than urban interests. To get them to act, therefore, both they and their rural constituents must be made to see that we cannot hope to

have a prosperous agriculture until we have prosperous towns and cities. Clearly, there is a sizable job of education to be done in both the urban and the rural communities.

Even when the educational task is accomplished, however, the legislatures still may ask what reason there is to believe that the towns could finance their rebuilding anyhow. What would be the use, the lawmakers might demand, of passing legislation that would accomplish nothing? To give a satisfactory answer, the towns will have to come to grips with the toughest of their problems—the removal of the second of the obstacles mentioned above.

THE DILEMMA OF OVERVALUED LAND

From the economic if not indeed from the social point of view, the most important of the principles of city planning outlined above is the third, the one having to do with elbow room in the interior of the urban community. To get plenty of it will involve a solution of the problem of land use and population density for all the principal subareas within the area to be planned. One fundamental requirement must take precedence over everything else: *overcrowding and congestion must be eliminated.* This means in the first place that ample space must be provided so that motor vehicles shall not be parked in the streets for any period whatever. It may mean also that space will have to be provided for small airplane landing fields; for if the number of airplanes in use should ever become remotely comparable to the number of automobiles, they will have to be landed in the middle of town rather than away out in the country. It means surely, in the second place, that in all residential neighborhoods there shall be plenty of open space for light and air. It means finally that most of the dwelling units must have plots of ground of their own. If people are to be expected to bring up children and thus enable the urban communities to maintain their population without dependence on immigration from rural areas, the families cannot be housed in tenements or apartments.

All this adds up to the inescapable necessity of a far less intensive use of interior land than has been customary heretofore. But in this case nothing like the present valuations placed on most of such land can be maintained. A drastic reduction will be indispensable. Who then is going to absorb the loss? If it were a matter of a parcel here and there, bought and held in the expectation of cashing in on a redevelopment project, the answer would be simple: laws radical enough to deal summarily with the situation. But it must be

remembered that much if not most of the land in question is held by individuals or institutions who have held it for a long time. In many other cases institutions hold mortgages on it—institutions which are the custodians of the savings of the people. They have acquired it or lent money on it in good faith, although usually without much understanding of the great forces and tendencies at work in the town. Already, however, where there is any real market, the prices have usually fallen considerably from the levels of a decade or so ago, although they are still substantially higher than could be justified for the new use in accordance with a sound master plan. This difference is what must somehow be got rid of.

Study of the broader aspects of the problem leads to the conclusion that the particular property owners involved here are no more responsible for what has happened than are the other inhabitants of the urban community. If they keep hanging on, as they feel they must, no doubt eventually the prices realizable for their property will sink low enough to make redevelopment a reasonably good risk. But if, as is here being argued, the community as a whole cannot afford to wait, the case becomes quite different. If then for the benefit of the entire community a reallocation is made of the use of a very large proportion of the entire land area, and the owners of blighted and slum property find their going market values suddenly reduced thereby, they could make a very strong case in court to prove deprivation of value in the public interest. Thus they could present a convincing claim for compensation at current market prices. And in that event the compensation would have to be paid them by the urban community as a whole.

Let there be no mistake: no argument is here advanced for using public funds merely to pay for the mistakes of people who have made bad investments. A common superficial reaction is to compare what is being proposed with relieving an investor or a speculator in the stock market of his losses when prices fall. Only a little thought is necessary to show that the comparison is fallacious. The really comparable case would be that of buying the stock at current market prices, regardless of what might have been paid for it by the present holder, before taking some sort of action, for reasons having nothing to do with the stock market, which would destroy a large part of such value as was still indicated by the market.

This dilemma of excess valuations of interior land can be resolved only through the intervention of the community as a whole. And such intervention will involve large sums of money, money which

under present and prospective circumstances the cities and towns cannot be expected to raise.

FEDERAL FINANCIAL AID

Now it is probably true that if the entire tax structure of the nation—Federal, state, and local—were thoroughly overhauled, most of the cities could meet the situation. The great bulk of the Federal taxes comes out of the cities, and, if only they could somehow retain a larger share of such taxes, their fiscal position might become excellent. Such far-reaching measures of tax reform are of course urgently needed. If they could be accomplished reasonably soon, the cities might be in a position to finance their own replanning and rebuilding. If this should happen, well and good; but a realistic appraisal of the prospects forces the conclusion that such a consummation is likely to be as long delayed as will be the fall of land valuations without public intervention. Consequently, another approach to a solution of this particular financial problem is needed. When we look around for it, we are obliged to conclude that there is little or no hope of help from the state governments, for these are in a position scarcely more favorable than that of the cities and towns. There remains then only the Federal government as the source of the funds required.

Once granted the proposition that clearing away the obstacles to sound replanning and redevelopment is the responsibility of the whole community, Federal financial aid is justifiable. For the situation has gone far beyond the proportions of a mere local problem: it is a matter affecting virtually all the urban communities and it involves more than half the population of the country. Consequently, as previously argued, the problem must be treated as one of national scope. Indeed, Federal policies share in the responsibility for the conditions which make replanning and redevelopment necessary.

If it is so treated, what might be a sound procedure? In a recent pamphlet of the National Planning Association (Washington, D. C.), I have collaborated with Prof. Alvin H. Hansen in suggesting the following:

For every town or city—or for every group of contiguous municipalities—a long-range master plan would be completed in broad outline for the entire metropolitan area. And, of course, it would provide for its own subsequent revision to meet unforeseeable needs. It would be formally submitted to the appropriate Federal agency in

connection with an application for financial aid in the acquisition of all the real property within a clearly defined slum or blighted area. For each such area and the immediate surroundings, the planning not only would have to be complete and in accordance with the master plan, but should also be accompanied by the data necessary to justify all assumptions as to future changes. Definitely indicated would be the proposed use of every square foot of the area, whether for public purposes or for leasing to private enterprise; and such use would be determined without regard to acquisition cost of the land. In other words, the acquisition would be a by-product of the job of clearing away the obstacles to redevelopment: in arriving at a decision as to its subsequent use, the land should be deemed to have cost nothing.

Decision as to acquisition, as well as to future kind of use, should be by the planning agency for the whole urban area, not by the local housing authority, because the considerations involved would be broader than housing alone.

Upon approval by the appropriate agencies in Washington of all aspects of a proposal to acquire property, the government would be prepared to advance funds, if need be, up to the entire cost of acquisition. Possibly repayment of the principal might be required, along with a share of the subsequent net proceeds from the property in lieu of interest. In view of the fiscal position of most municipalities, however, there are strong reasons for requiring them only to pay over, for 50 years or so, something like two-thirds of such sums as may be obtained from leasing the property, thus giving them a long breathing spell in which to undertake an overhauling of their tax structures. Of course, if they could accomplish tax reform at once, they might be able to finance the whole program out of their own resources and thus escape even the minimum of Federal supervision that would otherwise be unavoidable. And let me add here, parenthetically, that no centralized control over city planning is envisaged. Every possible safeguard should be included in the Federal legislation (and in the accompanying discussion of the intent of the laws) against interference with the local community in planning any sort of town it wants, so long as a few indispensable and obvious standards are adhered to.

Demolition and rebuilding in the acquired areas, or rehabilitation where this is feasible, would proceed as rapidly as all the attendant circumstances would permit. Meanwhile, public work activities of all kinds would be fitted into the larger program. Steady progress

would be made, over the years, toward realization of the growing and developing master plan.

THE HOUSING PROBLEM

It will be observed that thus far housing has had no conspicuous place in the present discussion. This was deliberate, for the reason that the housing problem, if attacked as such, seems to be insoluble. Essentially it is a problem of costs in relation to the incomes of the families to be housed. And a very large, if not the largest, element in such costs—if plenty of open space is to be provided—is land. Another very important element, of course, is the backwardness of the residential construction industry itself.

Apart from the matter of building costs, the chief requirement is for plenty of *houses*, not apartments, for rent. Home ownership, as far as financial arrangements are concerned, is now very well taken care of, through the Federal Housing Administration and the savings and loan associations operating under the Federal Home Loan Bank Board. But the owning and renting of single-family houses has been looked upon heretofore by real estate operators as an extremely unsatisfactory business. The reason is that such properties were never built for rent in the first place, but for home ownership. Their rental status is usually the result of mortgage foreclosures. Moreover, they are scattered here and there all over the place, so that it is difficult or impossible to operate them in a business-like way. But the conditions prevailing hitherto can be changed. Experience of a few rental projects with mortgages insured by FHA indicates unmistakably that when properly planned and grouped, the renting of single-family houses may become a highly satisfactory and moderately profitable enterprise.

The problem of urban housing, therefore, needs to be attacked from two principal sides. In the first place, in addition to the method outlined above for wiping out excess land valuations, an extensive program of research and experimentation should be undertaken, to modernize the construction industry. In fact, something is already being accomplished along these lines now by the consolidated National Housing Agency in connection with the production of war housing. The other measure needed is a method of doing for rental housing what FHA has been successfully accomplishing for home ownership. Clearly, as demonstrated by the meager results obtained under Section 207 of the National Housing Act, mortgage insurance for rental projects is not the answer. In

fact, those students of the problem most familiar with the FHA experience have reached the conclusion that only through insurance of the entire investment in rental properties can results be accomplished on a scale comparable to those in the field of home ownership. Consequently, a procedure has been fully worked out, in a form ready for introduction as an amendment to the National Housing Act, to accomplish the desired results—and to do so, moreover, with probably less risk to the government than is now involved in the insurance of mortgages on rental housing. The insurance would guarantee only a very low yield on the investment; would be granted only to owners who could qualify as thoroughly reliable and competent; would apply only to projects designed for rent to families of moderate to low income. There would be some form of guaranty of recovery of investment, but the minimum return insured would be so low that the owners would be under strong compulsion to operate the property so as to make it earn substantially more.

The measures mentioned above would not be sufficient at once to solve all the problems of housing the families in the lowest third of the income groups. Consequently there will be a place and an urgent need, for a good many years at least, for a substantial program of publicly provided or subsidized housing. While the experience to date of the United States Housing Authority probably does not indicate a solution of the problem, that approach should be carefully and sympathetically reexamined. My own personal opinion—admittedly somewhat vague—is that the ultimate solution will lie in reducing the cost of adequate housing, on the one hand, and in raising the incomes of the families now in the lower brackets, on the other. In the meanwhile some form of subsidy would appear to be indispensable, either of the families to permit them to pay commercial rents, or of the production and operation of the housing itself.

THE FISCAL PROBLEM

Supposing that all the foregoing suggestions are deemed acceptable in principle, will the fiscal capacity of the Federal government be adequate for the demands for funds likely to be made upon it? There are the best of reasons for believing that the answer will be yes. In the first place, the amounts to be advanced to the urban communities are likely to be much less than at first glance the magnitude of the undertaking would indicate. It is to be expected that by far the greater part of the rebuilding will be carried out by

private enterprise. The public investment, whatever its amount, will be made primarily for the purpose of removing the obstacles in the way of private development. Moreover, the governments of the local communities will undoubtedly be able to make some repayments, perhaps in a good many cases the entire amount advanced. At all events this will be a type of public investment characterized by a great multiplying power.

In the second place, the actual rebuilding program will be started and carried on for the most part when the demand for private investment funds is low—in other words, when a depression threatens. Reverting to the analogy of a well-run family estate, the job of rebuilding will be prosecuted in the spare time of the economy. This and other forms of useful public investment should be made, to whatever extent proves necessary, in order to take up any slack in employment that threatens to occur. If this be done, we may look forward to a permanent condition of substantially full employment, and consequently to a high national income.

It is true that by the end of the war we shall have a large internal debt of the government, perhaps approaching a figure double that of the national income. But there is excellent reason to believe, principally on the basis of the experience of Great Britain over the past 150 years, that a nation with a full-employment income can easily manage a debt substantially more than double that income. Consequently, if and when it becomes necessary to increase the debt for the purpose of making advances to the local communities, there need be nothing terrifying about the proposal. For we may be sure in the first place that the debt need never be fully repaid (but only refunded over and over again as has been done in England ever since the Napoleonic wars), and in the second place that in all probability periods of private investment boom will come, during which times the debt not only can but must be reduced in order to avoid price inflation.

These are ideas about government debt which may not be entirely familiar to those who do not understand the nature of public credit operations. They are, however, essentially matters of simple common sense. Space here is inadequate for further discussion of them, but I should like to refer the reader to an article entitled "The Federal Debt and the Future" by Alvin H. Hansen and myself, in the April, 1942, issue of *Harper's Magazine*.[1]

[1] See also Prof. Harris's essay on Post-war Public Debt in this volume.—EDITOR.

We shall have after the war the greatest productive organization in our history. Our equipment and skilled man power will be all set and ready to go; for the period of shifting from wartime to peacetime occupations need not be long and difficult, if we use a little foresight now. And be it remembered that *as a nation* we shall be debt-free, because we shall not have borrowed abroad. On the contrary, we shall have lent enormous sums. Also, *as a nation*, we shall pay for our war effort as we go. This is inevitably so, for the obvious reason that we can use up during the war only what we already have plus what we can produce. The complicated job we shall have later, with internal debt and taxation, can mean only that we are redistributing the cost of a job already paid for.

The fiscal task, to be sure, will be a large one, no matter what we do about the cities; but we are rapidly learning how to handle such things, and to do so without damage to the essentials of our way of life. We are learning at last how to make our financial mechanisms, not the masters but the servants of our society, how to make them fit the facts of our power to produce what we want when we want it. And surely the restoration to civic health of our towns and cities, a job we can surely do over the years to come, is one of the things we know we shall want.

Chapter XIII

FISCAL POLICY AT THE STATE AND LOCAL LEVELS

Harvey S. Perloff

The financial activities of the state and local governments, no less than those of the Federal government, must inevitably have an important effect on the national economy. In fact, war finance aside, the subordinate units collectively have always imposed more taxes and spent more money than the central government.

In the fiscal year ending June 30, 1941, before the United States actively entered the war, state and local tax revenues amounted to more than 11 per cent of the national income, while in the same period the expenditures of state and local governments amounted to almost 12 per cent of national income payments. We can safely assume that, although permanent changes in the public and private economies are certain to result from the war, the states and localities will continue to affect significantly the national economy. Whether they do so favorably or adversely is of utmost importance.

The record of the past is far from encouraging. There are serious limitations on the ability of state and local governments to follow an economically sound fiscal policy. Nonfederal units can be expected to contribute to the stability and progress of the economy only if certain fundamental changes are made in intergovernmental relations and in state and local financial structures.

FISCAL PERVERSENESS

The taxing, borrowing, and spending activities of the state and local governments collectively have been characterized by a fairly consistent perverseness from the standpoint of economically sound fiscal policy. They have followed the swings of the business cycles, from crest to trough. The governments have spent and built in prosperity periods and have contracted their activities during depressions. In the boom of the late twenties, their finances, instead of tempering inflationary pressures, added to the disposable income of

the community: inflationary borrowing was expanded and prices bid up in large-scale construction activities.

TABLE 1.—FEDERAL, STATE, AND LOCAL FISCAL POLICY INDICES, 1928–1939[1]
(In millions of dollars)

Fiscal year ending	Net income-increasing expenditures*		Expenditures for new public construction*		Taxes on sales	
	Federal	State and local	Federal†	State and local	Federal‡	State§
1928	− 77	810	188¶	2,104¶	1,054	‖
1929	−232	928			1,065	‖
1930	388	1,221	307	2,409	1,060	484
1931	2,419	1,291	422	2,156	839	531
1932	1,797	676	460	1,334	739	547
1933	1,809	−705	647	707	961	558
1934	3,460	−1,165	1,380	794	1,404	921
1935	3,568	−657	1,234	616	1,573	1,211
1936	4,374	−450	2,335	881	1,794	1,217
1937	1,114	−244	2,043	845	2,104	1,318
1938	2,225	−321	2,139	1,084	1,935	1,454
1939	3,581	209			1,905	1,475

[1] The measures employed here are extremely rough, but they serve to give a picture of trends.

* By sources of funds.

† Including work relief.

‡ Includes liquor, tobacco, manufacturers' excise, soft drinks, admissions, oleomargarine, and customs.

§ Includes gasoline, general sales, liquor excises and licenses, and tobacco excises and licenses. The license taxes could not be eliminated, because for certain years they are not reported separately. Their yield, however, is very small.

¶ Average for 1925–1929.

‖ Not available.

SOURCES: Net income-increasing expenditures: Estimates of Lauchlin Currie, *Temporary National Economic Committee Hearings*, Part 9 (Washington, May 16, 1939), p. 4011, as revised by Haskell Wald.

Estimated expenditures for new public construction: National Resources Planning Board, *The Economic Effects of the Federal Public Works Expenditures, 1933–1938*, prepared by J. K. Galbraith (Washington, November, 1940), pp. 17–18.

Federal sales taxes: *Annual Report of the Secretary of the Treasury*, 1941 (Washington, 1942), pp. 416, 484–487. State sales taxes: 1930–1935: Treasury Department, *Collections from Selected State-imposed Taxes*, 1930–1935 (Washington, November 30, 1936), Table *A*; 1936: Tax Research Foundation, *Tax Systems* (8th ed., Chicago, 1940), pp. 351–355; 1937–1939: Census Bureau, Division of State and Local Government, *Financial Statistics of the States*, annual series.

In the depressed thirties, the finances of these governments had a deflationary rather than an expansionary effect on the economy: expenditures, and especially construction outlays, were severely cut, borrowing was restricted, and taxes weighing on consumption were substantially increased. Table 1 reveals the cyclical

character of state and local construction activities and net income-increasing expenditures (*i.e.*, the net additions to, or deductions from, the disposable cash income of the community), as well as the sharp increase in sales taxes (*i.e.*, those taxes which weigh most directly and heavily on consumption). In following a countercycle expenditure program, the Federal government succeeded where the states and localities failed. In tax policy, however, the Federal government joined the swing toward consumption taxes.

Although the information now available is incomplete, it is evident that, in the current inflationary period, state and local governments are adhering to their record of fiscal perverseness. State and local authorities are submitting in many instances to the pressure to increase expenditures and to reduce tax rates.[1] Provisions for debt retirement, for the setting aside of reserves, and for the establishment of "shelves" of public works for postwar construction are few and far between—and this in the face of thoroughly sound resolutions and recommendations of the more important agencies representing state and local officials (*e.g.*, the Municipal Finance Officers Association and the Council of State Governments).

ECONOMIC AND INSTITUTIONAL LIMITATIONS

A number of important underlying factors have contributed to this unfortunate record of state and local finance. We must consider these factors to determine what adjustments have to be made if the fiscal household is to be set in order.

Financial Programs in Periods of Prosperity.

Fiscal perverseness in boom periods would seem to be due in the main to institutional factors. When treasury surpluses loom, strong pressures are brought to bear for the construction of capital works, on the one hand, and for the reduction of tax rates, on the other; state and local traditions of legislative resistance to pressure groups are far from well established. In addition, a number of state consti-

[1] There has been a 25 per cent decrease in the New York State personal income tax, and another reduction in tax rates is contemplated. Mississippi has also reduced its income tax rates, as has South Dakota. Illinois has lowered its general sales tax rate, while Indiana has reduced the rates of its gross receipts tax. A report by Rosina K. Mohaupt for the National Municipal League reveals that during 1942 cities with populations between 30,000 and 500,000 decreased tax rates, averaging 5 cents per $1,000 of assessed value, from the 1941 levels.

tutions and local charters require annual balancing of the budget, and thereby prohibit the accumulation of reserves. Limitations on the reduction of expenditures appear also in the form of large outlays for maintenance and replacement, which cannot be cut without impairing essential services (*e.g.*, waterworks, sewers, schools, and hospitals). Moreover, localities in a number of states find themselves saddled with certain mandatory expenditures. A further obstacle to reductions in expenditures is involved in the character of the existing grant-in-aid system. Both Federal grants to states and state grants to localities are rigid in their nature and hold out financial inducements for the grant recipients to keep up their expenditures in the aided fields during inflationary periods as well as during periods of depression. Of importance, also, is the fact that states and localities are limited in their ability to accelerate the rate of reduction of debt because the bulk of their bonds outstanding do not have "callable" features. On the whole, however, under prosperous conditions, there are few, if any, serious economic limitations to the pursuance by nonfederal units of a sound financial program.

Economic Limitations in Depression.

The situation in periods of depression is quite different, however. Then, state and local governments are confronted with serious economic obstacles to the carrying out of a countercycle fiscal program. In the face of a strong deflationary movement, most nonfederal units find it difficult to adjust their finances so that aggravation of the downward spiral will be prevented.

The ability of a governmental unit to maintain its expenditures and to add to the disposable income of the community depends fundamentally upon (1) borrowing capacity, (2) availability of reserve funds, (3) ability to obtain funds through taxes which do not reduce substantially the consumption of the community, and (4) grants from a higher level of government.

Municipal Credit.

There are strict limitations on the ability of states and localities to borrow in periods of depression. Being dependent, in the main, upon banks and other private investors—whose policies they cannot control—they can obtain funds only when they can meet the criteria of soundness set up in the municipal security market.

When tax yields shrink and borrowing becomes increasingly necessary in order to maintain service levels, the private market for municipals is most restricted. Credit can be obtained, if at all, only under unfavorable circumstances—short terms, high interest rates,[1] and stiff conditional requirements (in the form of provisions dictated by private investors concerning economies in expenditure, tax collection procedure, etc.). Most significant is the fact that the states and localities which had been hit the hardest could not obtain credit at all and were forced to default, to slash services, and, in some cases, to resort to the practice of printing scrip.[2]

Certain economic problems connected with nonfederal borrowing should be noted. Basically, for most state and local units, borrowing has the characteristics of the receipt of credit from abroad. Since to a large extent funds must come from institutions and individuals located in other jurisdictions, the payment of interest and repayment constitute a siphoning out of the area of current revenues, rather than a mere redistribution of income within the community. Unlike the situation for the national government which borrows from its own citizens only, the payment of interest involves a real cost to the members of a debtor state or locality. Moreover, the preferential claims of interest charges and repayment constitute an overhead cost in state and local budgets which, if large, impose a serious element of rigidity and may impair the ability of those governments to support their basic services. In the face of the extremely regressive state and local tax structures, the accumulation of large municipal debts would bring about, through the payment of interest and repayment, an income redistribution with unfortunate consequences. It would constitute a shift of important proportions from the consumer to the bondholder. Such a shift would be undesirable at all times except in periods of inflation.

[1] In 1932, in fact, no less than 78.7 per cent of all state and local issues bore rates of 4.5 per cent and higher.

[2] In 1932, 697 issues totaling $260 million could not find a market; in 1933, 528 issues with a dollar volume of $212 million failed of sale, including sales by such governments as Buffalo, Philadelphia, Cleveland, Toledo, Mississippi, and Montana. The governments were not shunning the capital market; instead they found access blocked. The establishment of PWA and the liberalization of RFC loans changed the picture substantially and assured a much broader market for state and local securities. It is patent that in the future the national government must stand ready to extend loans to nonfederal units on liberal terms, through an administrative structure which can assure prompt clearance of applications.

Of even greater importance from the viewpoint of fiscal policy is the fact that through deficit spending a state or locality can affect the level of income within its area only to a limited extent. The secondary effects of its spending will be diffused; the geographic "leakages" (the proportion of the new income not spent on domestic output) will be very large.[1] Moreover, an individual state or locality can be expected to spend its money on projects which answer its own immediate service needs. It cannot very well adjust its orders for materials in such a way as to obtain a maximum total "leverage" effect (*i.e.*, the maximum amount of induced investment and consumption). It may, in fact, aggravate maladjustments in the economy. Apparently, then, the states and localities can contribute to an expansionary policy only if guided by and underwritten by the national government. As a practical matter, the responsibility for the stimulation of income and investment must rest with the Federal government, for it alone is in a position to handle adequately the interrelated problems involved in the carrying out of a positive and flexible countercycle fiscal policy.

Prosperity Reserves.

A second source of funds for states and localities in depression is that of accumulated reserves. The availability of such funds depends on the foresight of the authorities and their resistance to pressures during the previous period of prosperity. Unless the prosperity period is of sufficient duration, the reserves cannot be expected to be of importance quantitatively. The most that can be hoped for is that they cushion the first impact of the depression and help to stop the deflationary spiral. Two safeguards are necessary. Adequate provision must be made to guard against raids on the reserves in prosperity and against depreciation of values in depression. If the downturn is sudden and severe, the bonds accumulated in the reserves may be dumped on the market, with serious deflationary effects on the market and on security values. This can be avoided if reserves are kept largely in the form of special Federal securities, or if national agencies are directed to purchase bonds offered by the state and local reserves.

[1] The production of construction materials, especially, is concentrated in a relatively small number of industrial areas. It is also worthy of note that, unlike the situation for large national units, state and local imports do not necessarily create exports which help to sustain employment. There is no adjustment mechanism at that level.

State and Local Taxes.

In general, limitations on borrowing capacity mean that the ability to add to the expendable income of the community must depend on the yield of nonconsumption taxes. Even so-called *nonconsumption taxes* are more or less deflationary, partly because they fall to some extent at least on the consumption stream, and partly because taxes per se are inherently restrictive. How serious a reduction of consumption is caused by a given tax depends, of course, upon the saving habits of the class of taxpayers upon which the tax falls. Because the bulk of individual saving is made by the higher income groups, estate, inheritance, and highly progressive income taxes constitute a relatively small drain on consumption compared with excise taxes on items which loom large in low-income budgets. Another type of problem, however, arises in connection with the first group of taxes, and that is the possibility of discouraging risk-taking investment at a time when such investment is crucial.

The states rely heavily on consumption taxes. This reliance arises largely from the inadequate yield of other state taxes. Although a majority of states now have personal income taxes, these taxes, with few exceptions, yield relatively little revenue. This can be explained, in part, by the fact that wealthy individuals are concentrated in a few centers, and most states do not have a large income base unless exemptions are extremely low. In 1938, for example, the percentage of incomes of $5,000 and over to total state income payments ranged from a minimum of 2½ per cent to a maximum of 28 per cent. In 35 of the 48 states, taxable incomes of $5,000 and over amounted to less than 10 per cent of total income payments within the state.

Competition among the states limits the steepness of income-tax rates which any one state can impose. A further limitation, especially for the agricultural states, arises from the difficulty of assessing farm incomes. Also, a number of the states do not possess the administrative and legal talent required to administer a modern progressive income tax.

During the thirties, when the income taxes and other cyclically sensitive taxes yielded little revenue, the states—in their desire to secure revenues that would enable them to obtain WPA and social security grants—turned to the least cyclically sensitive and most productive tax base, *i.e.*, the transactions base. Finally, the regressive character of the state tax structure is due in no small part to the fact that, in its development, considerations of eco-

nomic soundness were generally subordinated to political feasibility and to the expediency involved in "plucking the most feathers with the least squawk." Now about 50 per cent of all state revenues arise from taxes on sales. If the reliance on taxes that weigh heavily on consumption continues, the state tax structure can be expected to have a restrictive effect on the national economy during periods of depression.

Since localities are restricted in their ability to borrow, the level of their outlays will depend on the yields of the property tax—upon which they are almost entirely dependent—unless they have accumulated reserves or receive substantial grants from the Federal government or from the states. Because a property tax constitutes an overhead cost for individuals and businesses, it deals harshly with those whose incomes contract in depression. With property taxes levied at high rates in most areas, an avalanche of delinquencies can be expected during a period of depression. If a locality should attempt to sustain its outlays by raising tax rates to compensate for the losses due to delinquencies, it will probably increase the number of delinquencies. In a depression, also, the high rates of the property tax tend to have a depressing effect on real estate values and on the rate of private construction.

Grants-in-aid.

Grants from higher levels of government constitute another source of income for states and localities which may enable them to maintain their expenditures during periods of depression. Since most states find their financial resources severely limited in periods of depression, they can do little to aid their subordinate units. Chief reliance must be placed upon the Federal government.

Today most Federal-aid acts apportion fixed sums of money among the states on the basis of service need (generally measured by population), and require that the Federal grant be matched by state or local funds, usually dollar for dollar. The Social Security Act departs somewhat from this pattern, and authorizes indefinite grants equal to expenditures from state and local funds to meet public assistance costs falling within the limits of the Federal act.

Experience has indicated that where a grant is based on a matching or other uniform-ratio basis, the larger per capita grants generally go to the states with the greater economic and financial resources, and the states with the smallest resources as a rule receive the smallest per capita grants. Moreover, while the wealthier

states, or those least affected by a depression, can take advantage of Federal grants with comparative ease, the states with the least resources, or those hit hardest by a depression, can do so only by burdening their residents with extremely heavy—and generally regressive—taxes, or can do so at the expense of unaided activities. Thus, those governmental units which are most dependent on outside aid, if they are to maintain their services and their income-increasing expenditures, receive the least assistance under the present grant-in-aid system.

Relative Resources and Service Levels.

The limiting factors discussed above have forced state and local spending generally into a cyclical pattern. But the global figures hide significant differences among the various areas of the country. The ability of a nonfederal unit to maintain a high level of services, and to contribute to the disposable income of the community in times of depression, depends on its fiscal capacity, *i.e.*, its ability to raise revenue. If we examine a significant index of relative fiscal capacity among the states—*i.e.*, per capita income payments to residents—we find extreme variations. For example, in 1940 per capita income payments ranged from $195 to $960, with a national average of $573. The average amounts paid by the states to recipients of public assistance correlated directly with income payments: in November, 1940, the seven states with the highest per capita incomes (over $750) paid old-age benefits that averaged $25.78, while the seven states with the lowest per capita incomes (under $325) paid benefits that averaged $8.84 (even the most generous of these paid only $10.10).[1] The rates of unemployment compensation follow the same pattern: minimum weekly benefits for total unemployment for the seven richest states ranged from $5 to $10; for the seven poorest states the minimum payments ranged from $2 to $5.[2]

[1] The richest states, which provided aid to dependent children, paid average benefits ranging from $31.15 per family in one state to $58.50 in another, with an average for those states of $42.92. The range among the poorest states was from $13.69 to $21.30 per family, with an average of $16.69. See Social Security Board, Bureau of Public Assistance, *Distribution of Assistance Payments to Recipients, November* 1940 (Research Memorandum 2, Washington, May, 1941), Tables 2 and 12.

[2] Social Security Board *Comparison of State Unemployment Compensation Laws as of December* 31, 1941 (Employment Security Memorandum 8, Washington, December, 1941), pp. 86–87.

Outlays for public assistance are provided in part through grants from the Federal government, which cover a large share of the cost. In elementary and secondary education, where the only equalizing factor is state grants to localities, the disparity in service levels among states is most striking: for example, in 1939–1940 average expenditures per pupil (from state and local funds combined) ranged from $30 to $157.[1] In the depression of the thirties the poorer states lowered their education service levels drastically. Between 1930 and 1934, each of the 14 states with the lowest per capita incomes decreased their educational expenditures, and 11 of the 14 had percentage decreases in expenditures per pupil substantially more than the national average (22.2 per cent decrease between 1930 and 1934).

Obviously, the poorer areas of the country cannot finance an adequate level of services from their own resources, nor can they maintain their expenditures in periods of depression. In those areas where purchasing power is at the lowest level, the nonfederal units can contribute least to the disposable income of the community.

LOOKING AHEAD

It seems safe to proceed on the assumption that, whatever the rate of economic progress in the postwar period, we shall be faced with serious economic tensions and the possibility of violent cyclical fluctuations. It is imperative, then, that one of our most potentially effective economic weapons—the financial machinery of government—be geared to making its full contribution.

The conclusion seems inescapable that if public finance is to contribute to the progress and stability of our economy, certain drastic revisions must be made in governmental fiscal structures and in intergovernmental relations. Were it not for one factor, a discussion of "drastic revisions" would definitely be of the "ivory-tower" variety. That factor is the assurance that political groups

[1] U. S. Office of Education, *Advance Statistics of State School Systems*, 1939–1940 (Washington, May, 1942). A similar discrepancy may be noted in other local service levels. A study of 34 important urban areas throughout the country made by the Children's Bureau of the Department of Labor reveals that in 1940, per capita net expenditures for health and welfare services (*i.e.*, excluding payments by persons receiving service) ranged from $13.32 to $52.86. These 34 cities grouped by regions show that the average per capita disbursement for health and welfare services for the cities in the South was one-third below the average for all areas. Children's Bureau, *The Community Welfare Picture in 34 Urban Areas*, 1940 (Washington, June, 1941), pp. 9, 11.

cannot hope to retain power, under modern conditions, unless they can successfully deal with the problems of economic instability and individual insecurity. The foregoing analysis would seem to indicate that, if sound, coordinated fiscal programs are to be carried out and if adequate levels of service are to be maintained throughout the nation, there is need for action along several fronts.

Toward Eliminating Fiscal Incapacity.

The vicious cycle in which the poorer areas of the country find themselves must be broken. The fiscal incapacity of these areas largely precludes their pursuance of economic and financial programs which would enable them to improve living standards and to meet successfully the onslaught of depression. This is not a problem for the economically backward areas alone; it is the concern of the entire nation. The poverty of undeveloped and exploited areas spreads like infection to other communities. Moreover, when children grow up without sufficient nourishment and medical care and without adequate training, when disease and sickness are high, and when workers are permitted to lose their skills, the whole nation loses in productivity and fails to achieve its potential. On the other hand, growth in one region generally fosters growth all around. To provide economic opportunity for the people of an area and thereby to increase their buying power is to expand the market for goods produced in other areas of the nation and to open attractive outlets for investment. For the areas with inadequate fiscal resources, ability to solve the problems of cyclical fluctuations is contingent on the improvement of economic capacity and the achievement of a better balance in service levels and in purchasing power levels as between different areas of the country. A multiform attack on the problem seems necessary.

1. *Long-term Programs of Development.* Through the cooperative effort of the Federal, state, and local governments, long-range developmental programs should be undertaken to bring about the effective utilization of land, water, and mineral resources, so that every region may develop as broad a base of economic activities as its natural resources can economically sustain. The planned and intensive development of native resources and markets is crucial for the poorer areas of the country. It is an important key to economic expansion.

2. *Reallocation of Certain Governmental Functions.* The Federal government must necessarily assume the responsibility for the ade-

quate performance of public services which are of direct national concern. The responsibility might be discharged either through actual administration or through increased financial participation, together with control over standards of performance.

The reallocation of functions—either administrative or financial—is called for especially in two groups of public services. The first group includes those services that are essential to guarantee healthy, productive individuals and to prevent the creation of permanently underprivileged classes. Among these services fall education, nutrition, child and maternal welfare, medical care, and public housing. Broadly speaking, the provision of an adequate level of such services is necessary to increase the potential income-producing power of areas where low income is attributable to long-standing economic handicaps rather than to the ups and downs of the business cycle. The second group of services includes those whose objective is to relieve the acute forms of human distress associated with extreme poverty. In this category fall social security and relief. The maintenance of an adequate level of payments throughout the country, especially of unemployment benefits and relief, is essential if distress is to be alleviated wherever it may occur and if the purchasing power of low-income areas is to be improved. Only Federal administration or a high degree of Federal financial participation (on an equalizing basis) can put a floor under these crucial public services.

A reallocation of functions and costs from one level of government to another must inevitably result in a shift in burdens from certain groups of taxpayers to others. This follows from the differences in tax structures leading to varying impacts on the money streams of the economy. Because of the breadth of Federal tax bases and the relative progressiveness of the national tax system, a shift of certain burdens to the Federal government has much to commend it from the standpoint of equity and economic soundness.

3. *Variable Grants.* The grant-in-aid is a convenient tool for achieving a better balance in service levels and in purchasing power between different areas. To achieve greater equalization, distribution of the grants should be based on the needs and resources of the recipient units.

Where, for the services discussed above, a relatively high degree of Federal financial participation is preferable—for political or administrative reasons—to direct central administration, such participation should take the form of variable-ratio grants, as

opposed to uniform-ratio or equal-sharing grants. The percentage of Federal participation (possibly within a range of 25 to 75 per cent) would be related to the significant differences in the resources as well as in the needs and tax efforts of the various states. The Federal percentages would vary inversely, and the state percentages directly, with state resources, possibly measured by average per capita income, which is a rough measure of both resources and needs. Under a plan of this sort, in the states with relatively low resources the increased Federal grant would offset the small amount of funds which such states can obtain through their own tax systems, making it possible for these states to provide the nationally important services at levels of adequacy not much different from those of the states that have larger financial resources.

Where the responsibility for the administration of a service is shared by both the state and its localities (*e.g.*, education) or is entirely a local function, the Federal grant should be conditioned, among other things, on the distribution by the state of grants to localities on a similar variable-ratio basis. This is necessary because differences in resources among the various areas *within* the states are extreme. For example, a recent study of county taxable resources in Ohio revealed that per capita assessed valuation (Ohio law requires 100 per cent valuation) ranged from $571 to $1,759. The picture for other states is undoubtedly not far different than that of Ohio. The equalization purpose of Federal grants would be defeated, in part at least, unless the states allocated funds to localities on the basis of relative needs and resources.[1]

4. *Local Consolidation.* In the case of localities, a better balance of burdens and resources can be achieved through local government reorganization. Generally speaking, inequalities in resources and burdens decrease as the size of the district increases. In rural areas, the problem is essentially one of shifting key governmental functions from the manifold small districts to large county areas. In urban areas, the development of metropolitan governments is of prime importance. It would go a long way toward solving certain of the problems inherent in the present tendency for wealthy families to move to independent suburban districts, leaving the central city with heavy burdens and a small tax base. The formation of such metropolitan areas could be carried out directly in connection with

[1] It is important, of course, to guard against the tendency of freezing uneconomic situations through grants-in-aid, or, for that matter, through public works. The death struggles of decadent communities should not be prolonged.

much-needed long-range programs of urban redevelopment. Local consolidation might well be a precondition of Federal grants to states and localities.[1]

Toward Improved State and Local Fiscal Structures.

In addition to ensuring greater equalization in burdens and resources, the foregoing proposals, if adopted, would undoubtedly place the nonfederal units as a group in a better financial position than at present. If the Federal government were to assume a substantial share of the cost of carrying out the public functions which are of direct national concern, state and local revenues might well be adequate for the remaining responsibilities.

For the localities, the pivotal point would be increased central financial support of public education. In recent years, public school costs have amounted to roughly one-third of total local expenditures. In 1941, for example, local government expenditures on schools were $2,240 million out of a total outlay, exclusive of debt retirement, of $6,730 million. The states contributed $735 million to the localities—or one-third of the educational costs—in the form of grants, while the Federal government contributed only $83 million in grants, chiefly for vocational education.[2] If the Federal government were to assume the responsibility for roughly one-third of total educational costs, and the states another third, both in the form of equalization grants, the localities as a group would find themselves in a much healthier financial position.

The ramifications of such a shift in burdens are extremely important. For one thing, the poorer localities would be in a position to finance other local services more adequately. For another, pressure on the property tax would be reduced. The property tax has deteriorated in recent years, mainly because of the heavy burden that it has had to bear. Relief of this burden can be expected to

[1] The reorganization of local governments into logical economic and administrative units is needed also because the carrying out of sound fiscal programs requires a broad scope for planning and for financing, as well as expert administration. Successful reorganization would bring within the scope of local authority an area for which significant plans could be drawn up for such matters as zoning, residential construction, transportation, recreational centers, and, in general, the development of desirable cities and towns.

[2] Of this sum, $61 million were for defense training. Another $30 million were distributed, in loans and grants, directly to the localities faced with special educational problems growing out of the war effort. In 1940, only some $55 million in Federal grants were distributed for public education.

result in better administration of the property tax and in fewer delinquencies, and it would help to remove the block to construction activities. The financial position of localities could be improved further through an increase in local sharing in certain state-collected taxes. Complete local reliance on the property tax is both inequitable and economically unsound. It seems advisable that the states share with their localities yields from gasoline and automobile taxes and licenses. Local governments spend large sums on highways and streets;[1] yet they receive little—in many cases nothing—from automobile and gasoline taxes.

Federal assumption of the unemployment compensation program in whole or in part, and some of the burden of relief of employables, would be an important factor in preventing fiscal breakdowns and inadequate assistance to the unemployed and needy in periods of depression.

Tax Reform.

Certain changes in state and local tax structures are essential if public finance is to contribute to the progress and stability of the economy in the postwar period. It is necessary to eliminate the tax barriers to interstate commerce as well as the disrupting effects of an irrational assortment of business taxes and of the competition for business enterprises through the use of the tax mechanism. Of paramount importance, also, is a shift away from consumption taxation to income taxation. The personal income tax has shown itself capable of yielding huge revenues in periods of prosperity. If the states were to follow the practice of setting aside reserves in prosperity periods to be used during depression, the pressure to rely on the more stable, but regressive sales taxes would be relieved.

Significant improvements would undoubtedly result from the adoption of a single nationally administered business tax, either a business net income or corporate net income tax. A certain share of the yield—possibly one-quarter or one-third—would be allocated to the states on the basis of the widely accepted "Massachusetts formula" (based on ratios consisting of gross receipts, pay rolls, and tangible property). The advantages which would accrue from the substitution of such a single tax for the present chaotic mass of business taxes are many: (1) The single business tax would reduce enormously the costs of collection and of compliance; (2) it would

[1] In the fiscal year ending June 30, 1941, local government expenditures for highways and streets amounted to $467 million.

eliminate the unhealthy competition for business concerns which now exists between the states; (3) it would eliminate certain of the interstate tax barriers and discriminations against "foreign" concerns; (4) it would permit business enterprises to plan more securely; and (5) it would lessen the burden on private enterprise during periods of financial distress. Additional improvements could be brought about by incorporating into the business tax certain features which would create a favorable basis for the emergence of new private investment; among others, the encouragement of investment in equity capital, the elimination of discrimination against businesses with highly fluctuating incomes, and the granting of tax credits for new investment.

Another measure which can be expected to improve greatly the fiscal structures of the states is the adoption of a system of state supplements to the Federal personal income tax, such supplements to be collected by the Federal government along with its own levies and returned to the states. Such an arrangement would give the states complete independence as to whether or not they use the personal income tax and as to the rates to be applied. It would, however, have a number of important advantages: (1) It would reduce the costs of administration and compliance; (2) it would undoubtedly encourage a much greater uniformity in rates among the states; (3) it would permit the use of the income tax by those states which at the present time do not possess the administrative and legal talent required to administer such a tax; (4) it would enable many of the states to assess more adequately income in kind and farm income generally; and (5) it could be expected to encourage a greater reliance on the income tax.

Credit Policy.

If nonfederal units are to be in a position to maintain their essential services and to contribute to the disposable income of the community, state and local credit operations must be facilitated. It becomes incumbent upon the Federal government, with its superior credit standing, to underwrite state and local borrowing. The national government should stand ready to extend loans to the subordinate units at the lowest possible interest rates. This would amount, in principle, to an extension and liberalization of the credit policies pursued by the Reconstruction Finance Corporation and Public Works Administration in the depression of the thirties. The controls involved in the extension of loans to state and local

governments could be employed to bring about a greater conformity to national economic policy.

Fiscal Patterns.

A reallocation of functions and of taxes which resulted in a larger scope for national fiscal policy would enhance the field for coordinated and flexible financial programs. It seems apparent that the states and localities, with few exceptions, are in no position —economically or institutionally—to follow a flexible countercycle fiscal policy. The most that can be expected—and possibly the most desirable arrangement—is that they stabilize their financial activities. This would involve the setting up of reserves and the advance planning of public works in prosperity to enable them to sustain their expenditures in depression. The states and localities would maintain tax rates in prosperity, and during periods of depression they would refrain from adding to the tax burden. They would borrow in depression, from a Federal loan agency as well as from private investors, to fill any gap in revenues that may appear.

The additional responsibilities placed on the national government would make more imperative than ever improvements in Federal finances and administration. Improved management of fiscal policy is urgently needed. Of crucial importance also is a greater degree of decentralized administration. Responsiveness to the needs of the people directly concerned must be safeguarded as much as possible. A Federal-state-local commission to advise Congress and the President on matters of intergovernmental relations would undoubtedly make for better understanding and cooperation at all levels of government.

The Question of Centralization.

Admittedly, the proposals set forth above would involve certain drastic departures from existing fiscal structures and intergovernmental relations. The indications that such steps must soon be taken are so clear, however, that we have only the choice between trying to plan for this development as wisely as we can or letting it be forced upon us by the pressure of events.

These indications lie partly in the likelihood of a repetition of our experience during the depression of the thirties. The period was characterized by fiscal breakdowns and chaos and severe suffering. It was marked by numerous tax delinquencies in dis-

tressed urban and rural areas, a breakdown of the local relief structures, a wild scramble for tax sources with a shift to regressive taxes, and an expansion of certain centrally aided programs at the expense of other governmental functions. It seems inevitable that a repetition of such an experience would compel the national government to assume a major share of the responsibility for combating the depression.

At the present time, under the stress of the war program, the Federal government is assuming an ever-increasing share of the responsibility for the performance of governmental services. Not only is it absorbing new functions, but it is stepping in to remedy specific maladjustments and abnormal needs both in individual geographic areas and in individual sections of our economy. The question, then, is largely one of whether or not this trend should be extended, in a planned fashion, into the postwar period.

The prospect of increasing centralization generally conjures up fears of totalitarianism and dictatorship. The obvious lessons of history, however, should not be overlooked. In each instance, during modern times, dictatorship has come as a result of social and economic breakdown. Frustration and chaos are the forebearers of totalitarianism, not centralization. Certainly, the experience of Great Britain, with a unitary form of government and an ever-increasing degree of centralism, does not bear out the fears of those in the United States who see in the increasing importance of the Federal government the opening wedge for dictatorship.

Moreover, our traditions of local initiative would not be done away with. On the contrary, a proper allocation of functions will serve to remove from states and localities the onerous burden of problems which they cannot manage, and to enable them to concentrate on the proper administration of functions of a local interest. A healthy local financial structure is decidedly conducive to civic interest and pride.

PART V

Labor and Social Security

CHAPTER XIV

LABOR AFTER THE WAR

SUMNER H. SLICHTER

I

What will be the position of labor in the United States in the postwar world? What will be its problems? What will be its position on national issues? What contribution will labor be willing and able to make toward solving the postwar problems of the nation?

II

The war will produce important changes in the position of labor. Not all of these can be foreseen. Among the changes which seem most certain to occur are:

1. An increase in nonagricultural employment relative to agricultural employment. This will be the result of the unwillingness of many young men drawn from agriculture into the war industries and the armed services to return to farming. Prior to the war about one-fifth of the gainfully employed persons of the country were in agriculture. The demand for agricultural products, however, was not sufficient to produce a good living for such a large proportion of the gainfully employed. Consequently the average income of the farm workers was roughly only two-thirds of the average income in nonagricultural employments. The improved distribution of labor after the war will tend to reduce the disparity between the incomes of farmers and industrial workers. To that extent it will reduce the downward pull of large agricultural labor supplies upon wages in those industries which can readily establish plants in small country towns.[1]

2. A far better trained working force than the country has ever possessed. Never before has systematic training been given in American plants on a scale comparable to that of the last 2 years.

[1] The spread between farmer incomes and industrial wages may be kept large or even widened by postwar tariff policy.

The scope of training will increase as the war continues. The training is not confined to industry. It is being given on a large scale in the army, navy, and air corps. Some of the jobs for which people are being trained will not exist after the war, but the results of training in precision, in close attention, in responsibility, and in self-reliance will persist. Furthermore, many of the skills will have important peacetime applications. This is true of welders, airplane pilots, tool- and diemakers, all-round machinists, and maintenance men for aircraft, radio, and many other occupations. The availability of large numbers of well-trained workers will have an important influence upon postwar industrial practices and development.

3. Far more attention to systematic training and upgrading of workers. Before the war progressive personnel men had been persistently emphasizing the need for better training and systematic upgrading. Their progress was slow because of preoccupations and prejudices which prevented top management in most American plants from gaining insight into labor problems. As a result of the war, systematic training and upgrading has made as much progress in 3 years as it would have made in a decade. The extension and development of systematic training will be important both in raising labor efficiency and in compensating in part for the restrictions on labor mobility imposed by seniority rules. Training will also improve industrial relations by giving men a better opportunity to advance within a plant.

4. An enormous extension of industrial research. Research had been growing rapidly in the 20 years before the war. Here again we see the war forcing a far faster development than would have otherwise occurred. The effect will be cumulative because an extension of research by one concern forces an extension by others. The great impetus given to industrial research by the war will increase the elasticity of the demand for a wide variety of products and hence will increase the elasticity of demand for many kinds of labor. It may also cause workers to be confronted to a greater extent than ever with the problems of technological change.

5. Broader employment opportunities for Negroes. The Negroes' uphill fight to win a foothold in new occupations fluctuates with the labor market. When men are scarce, Negroes gain ground; when jobs are scarce, they lose part of their newly won opportunities. The acute labor shortages of the war are giving them an unprecedented opportunity to break into factory and

office work from which they had been excluded. A good part of these gains will be held.

6. Larger and stronger trade unions. Trade unions may suffer to some extent because of excesses committed in their name during the war and because some unions have gained power faster than is good for any group of men. But although unions may suffer in public esteem, they will gain in members and power. The reason is that the war has given the government an opportunity to impose union security clauses upon many employers. In the absence of the war, a few organizations would have won union security clauses by strikes or threats of strike, but the gains would have come far less rapidly than they have come through the National War Labor Board. The spread of unionism will require many changes in managerial personnel, from foremen to presidents, and the replacement of the slipshod personnel administration that has been characteristic of American industry with management of far better quality.

7. Spread of union-management cooperation in improving methods of production. The production committees fostered by Donald Nelson have done good technical work in some plants and have advanced little beyond ballyhoo in the great majority. Nevertheless the committees are helping to break down prejudices among both workers and employers to the idea of organized participation of workers in improving methods of production. Competitive conditions in the metal trades after the war are likely to promote the use of production committees in those industries.

8. New leadership in business and labor. When the soldiers and sailors return, many men who have developed qualities of leadership under the severe conditions of war will forge ahead in both business and unions. It is impossible to predict how the new leadership will affect the policies of business and unions, but the returned service men are bound to be important in all branches of national life and their points of view will be affected by their war experiences.

III

Most unions believe that their principal problem after the war will be fighting deflation and unemployment. Some of them are accumulating funds for fighting wage cuts.

Whether the cessation of the war is followed by a boom or a collapse will depend upon whether private expenditures for goods

rise as rapidly as public expenditures decline. For 6 months or more after the war millions of war workers and others who fear unemployment will spend cautiously. The proportion of war workers to civilian workers will be far higher than in 1918 or 1919. Hence their fears and caution are likely to influence the economic situation to a greater extent. Tending to offset the restraining effect of fear upon demand will be the large volume of shortages—the result of the lack of availability of goods during the war. The current output of civilian goods, when hostilities cease, will probably be no more than two-thirds of normal and may be much less. Some rise in civilian demand above this level seems almost inevitable. The government, therefore, by limiting the drop in its expenditures, can prevent a drop in total demand.[1]

If the government does a reasonably good job of managing its expenditures so as to prevent a drop in total demand, the fears and uncertainities of the war workers and others will become less and less effective restraints upon spending. Furthermore, the urge to make long-deferred purchases will become more pressing. If the war lasts until the middle of 1944, the volume of deferred purchases in the United States will be about $25 billion.[2] The amount of purchasing power available to convert these accumulated needs into effective demand will depend in large measure upon how successfully prices are controlled during the war. If prices are held down with reasonable success, people will be able to spend only about 60 per cent of their incomes (after taxes) for goods. They will be compelled to use the remaining 40 per cent for the purchase of war bonds or for building up deposits of idle cash. The rise in prices during the first 3 years of the war has been considerably less

[1] It is possible that the physical necessity of making large expenditures to support millions of men under arms may prevent a very large or sudden drop in government expenditures. In the fiscal year 1918–1919, which contained only 4⅓ months of fighting, government expenditures were nearly 50 per cent above the fiscal year 1916–1917. The government may not be able to cut its expenditures as fast as the rising demand for civilian goods makes desirable. The effect of government purchases of goods upon incomes occurs in the main many months *before* the government pays for the goods. It occurs when the raw materials are paid for or pay rolls are met either through the working capital of the enterprise or through bank loans. Hence it is possible for the government, through reducing new orders, to cut the income-increasing effect of its budget even though actual payments on old orders are rising.

[2] For an estimate of the volume of deferred demand by principal categories see my article, "Postwar Boom or Collapse," *Harvard Business Review*, Fall Issue, 1942, pp. 7–10.

than during the first 3 years of the First World War; and the outlook is reasonably bright for the accumulation of a large volume of war savings bonds and demand deposits, which millions of persons will wish to convert into goods as soon as hostilities cease. If prices by some miracle were held substantially to the level of July, 1942, the "surplus" savings (*i.e.*, the savings which people are not prepared to keep as such for a very long period after goods become available) will amount to nearly $40 billion by the middle of 1944.[1] Even a moderate rise in prices would permit an accumulation of surplus savings of $20 billion.[2] If surplus savings are very large, the problem of preventing a postwar boom will be extremely difficult and will require the use of extraordinary methods—restrictions on the redemption of war bonds, the continuation of heavy rates of taxation, the continuation of price control.

IV

Will the policies of organized labor make it easier or more difficult for the government to prevent a postwar boom? In answering this question, one should distinguish between the economic policies of organized labor and its political policies.

The economic policies of organized labor are likely to help prevent a postwar boom. As indicated above, the basis for the threat of a boom will be an abnormally high propensity to consume —the result of efforts to convert surplus savings into goods. The effect of the high propensity to consume may be offset, in part at least, by an unfavorable shift in the investment function. Union wage policy will tend to keep the prospect for profits unfavorable, because unions will press for wage increases despite the continuation of price controls. The practical effect of union wage policies in preventing a boom may not be important during the first year or two after the close of hostilities. On the one hand, the execution of most long-term investment plans will be discouraged by the all-pervasive uncertainty; on the other hand, the unfavorable effect of union wage policy upon the marginal efficiency of capital will not

[1] For the basis of this estimate see my paper, *op. cit.*, pp. 15–16.

[2] If the price control is ineffective and there is a large rise in prices, there may be no accumulation of "surplus" savings. In fact, the war, by reducing the purchasing power of accumulated holdings of cash and securities and of income from the latter, may actually produce a deficiency of savings. This deficiency would manifest itself after the war by a decline in the propensity to consume, a result of the efforts of people to restore the purchasing power of their savings by increasing their current rate of saving.

greatly discourage enterprises from making the urgent replacements of equipment which will represent most of the equipment buying immediately after the war.[1] Union wage policy in the building trades may limit the demand for housing, but experience after the First World War indicates that people are likely to be cautious in purchasing new houses until the transition from war production to civilian production has been pretty well completed and until the outlook for civilian employment has been clarified. As the transition proceeds and as urgent shortages are met, demand schedules for all goods, but especially investment goods and labor, will become both more elastic and more "shiftable." Union wage policies will then produce more pronounced effects. In addition there will be delayed effects of wage adjustments made during the period of highly inelastic demands. All of this will help prevent a boom during the years when surplus savings are being worked off and demand deposits are abnormally large in relation to prices and production.

V

The political policies of organized labor during the first 2 or 3 years after the war are likely to affect the stability of the economy even more than its economic policies. No one, however, is in a position to predict what the political policies of the labor movement will be and, therefore, whether they will tend to make the economy more or less stable. The crucial questions are the positions that organized labor will take on the redemption of war savings bonds, on taxation, and on price control.

One is tempted to predict that labor will oppose restrictions on the redemption of war savings bonds, will demand large and immediate reductions in taxes on the lower income brackets, and will demand the termination of most forms of price control (since price control will hinder unions in negotiating wage increases). These would be the easy demands for labor to make. They would reflect pretty adequately the shortsightedness and the ignorance of the man in the street—his obliviousness to the danger of an uncontrolled boom, his difficulty in thinking in terms of general rather than particular interests, his trouble in taking account of the long run rather than the immediate consequences of decisions.

[1] Fear of higher labor costs may be so great that the first effect of union wage policy may be to raise the demand for industrial equipment.

These are demands which will be made with much noise by a host of demagogues who will proclaim themselves friends of labor.

If the labor movement were to take these stands, it would represent a great failure of the principle of labor organization. The man in the street cannot be expected to think very concretely in terms of his general interests and in terms of the long run. This is one reason why he needs organization—so that through men whom he trusts and whom he regards as capable of representing his general and long-run interests he may be protected against blindly and naïvely reacting solely in terms of immediate and particular interests.

It is possible that the labor movement in the years immediately after the war will fail to represent the general and long-run interests of its members in economic stability. Eagerness to make long-deferred purchases will be great, and people will be highly impatient with anything which limits their ability to buy. Restrictions on the redemption of war bonds will not be popular. The demand for large reductions in taxes on the lower income brackets will be eagerly pressed and vigorously exploited by some politicians. Price control will be less unpopular than taxes or restrictions on the redemption of war bonds and will have a better chance of surviving. It may survive even though unions oppose it on the ground that it limits their ability to win wage increases.[1] Price control will not be effective, however, unless accompanied by a broad system of rationing.

It is not unrealistic to conclude that the balance of power in the struggle over the prevention of inflation after the war will be held by organized labor. Whether stability is achieved through the effective control of the conversion of surplus savings into goods or whether there is a runaway boom followed by a great collapse will depend upon whether the trade unions support the retention of controls during the critical transition period when the consumption function is abnormally favorable. They will not support a policy of control unless their leaders are capable of thinking in terms of the economy as a whole and not simply in terms of the immediate

[1] The politics of price control may be compared to the politics of the tariff. Each union may support the *general principle* of price control, but demand relaxation of control of the prices of particular products in which it is especially interested. It is impossible to predict the net result of such a conflict between support for control in general and opposition to control in particular. A compromise is indicated.

markets for particular industries and immediate employment in particular industries.

VI

Suppose that the immediate problem after the termination of hostilities is one of averting deflation rather than of preventing a boom. This might well be the case if price control were to break down pretty completely during the war so that there would be only a small accumulation of surplus savings to convert accumulated needs into effective demand. Would the economic and political policies of unions help or hinder the fight against a postwar deflation?

The economic policy of unions in nearly all instances would be to resist wage cuts. Some economists believe that wage cuts produce unfavorable shifts in the investment function (and thus intensify depressions) by arousing the expectation of further wage cuts and price cuts. Undoubtedly an unrestrained struggle by each employer to improve his condition by wage cuts, such as might occur in the absence of unions, might arouse unfavorable expectations and thus accentuate the depth and possibly the length of the depression.[1] Hence unions, by holding wages rigid during depression, might keep employment higher than it would be in the case of competitive wage cutting. But rigid wages also have unfavorable consequences.[2] Hence one cannot be certain whether rigid wages would permit more employment than competitive wage cutting.

Better for employment than either competitive wage cutting or complete rigidity is selective wage cutting. A period of contraction is a time when all demand schedules are abnormally inelastic and also when they have a one-sided "shiftability," *i.e.*, when they shift

[1] The effect upon the length of the depression is less certain than the effect upon the depth. The more severe the depression, the more complete is the postponement of commitments of all sorts, and the faster the accumulation of deferred demand. Consequently, an earlier turning point would be a possibility.

[2] Rigid wages do not prevent the expectation that wages *might* be cut. Consequently, they do not prevent the postponement of commitments. Rigid wages are likely to produce less favorable cost-price relationships than wage cuts. Unfavorable cost-price relationships retard the repayment of debts and the improvement of the cash position of business enterprises. Since the execution of many plans, such as the catching up on deferred maintenance, depends upon the cash position of the concern, unfavorable cost-price relationships would limit the demand for goods. Finally, since short-term marginal costs include raw materials, rigid wages tend to depress raw material prices and, hence, farmer incomes. This means that rigid wages may have little or no favorable effects upon the propensity to consume.

more readily in response to unfavorable influences than to favorable ones. Even at such times, however, there are a few commodities for which the industry demand is elastic. In such cases, wage cuts would help employment. Furthermore, many concerns can cut some or all of their rates without provoking an appreciable number of competitors to make offsetting cuts and, therefore, without producing offsetting cuts in prices. Cuts of this sort create investment opportunities for the particular firms and thus produce favorable shifts in the investment function. Finally, there are the wage cuts which induce little immediate employment because of the inelasticity of demand but which create more favorable cost-price relationships and which, therefore, pave the way for recovery when various changes in the business situation cause demand schedules to become more elastic and also more shiftable in response to favorable conditions.

Union wage policy in its present stage of development is definitely hostile to selective wage cutting. As unions gain experience in selling labor, they may be expected gradually to adopt more flexible and discriminating wage policies. Progress in that direction, however, will occur slowly and will not affect union wage policy in the years immediately after the war. Consequently, one cannot be certain how union wage policy will affect the problem of averting deflation after the war, should that problem arise. If rigid wages produce a higher level of employment than competitive wage cutting (which is uncertain), union wage policy will help avert deflation. But one can be sure that the unions will not be ready to support the wage policy which would be most effective against deflation—the policy of selective cuts designed to take advantage of elastic demands and of opportunities to create investment outlets.

VII

How would union political policies affect the problem of fighting a postwar deflation? If deflation occurred, the public, with the support of organized labor, would insist upon unrestricted redemption of war savings bonds and prompt repayment of forced savings. As a result, a severe deflation would be halted.[1] Deflation would

[1] This would not prevent the continuation of a persistent creeping deflation over a number of years, provided the outlook for profits were extremely unfavorable. Even a highly favorable consumption function cannot offset the effect of an extremely unfavorable investment prospect. The unfavorable outlook would

prevent there being a question of the retention of price ceilings. On the contrary, there would be a great demand, especially from farmers and raw material producers, for price "floors." Labor would probably support such schemes because its traditional prejudices have been in favor of "stabilization." Whether commodity stabilization schemes mitigated or intensified the deflation would depend upon how they were administered, particularly upon how the liquidation of supplies was managed.

Deflation would raise important questions of tax policy and government spending, and the position of organized labor would be important in each case in determining the course adopted. It is significant, however, that union leaders have given little consideration to the use of fiscal policy in combating deflation beyond suggesting an expansion of public works. This means that organized labor is not yet well prepared to consider the problems which might be raised by the wide variety of circumstances that might accompany a deflation. For example, deflation might occur because the large yields of war taxes produced a substantial surplus over postwar government expenditures. In this case a reduction in taxes rather than an increase in expenditures might be indicated. Or deflation might occur in spite of a large government deficit because extravagant demands of veterans for service allowances and pensions, of farmers for subsidies, and of workers for wage increases produced a dread of the future and led individuals and enterprises to hoard cash in large quantities. Experience between 1933 and 1940 indicates that hoarding of cash because of fear of the future may almost completely offset the stimulating effect of large deficits. The fears which encourage the hoarding of cash may be partly fears of higher taxes, *i.e.*, fears aroused by the deficit itself. If fears of the future are causing large-scale hoarding, direct attacks on the causes of the fears may be more effective than larger deficits. Certainly one cannot expect to offset by larger deficits every defect in policy which produces deflation. Organized labor, however, has not yet had occasion to probe carefully into these matters and is disposed to support the simple view that the remedy for every defla-

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discourage not only the shift from war savings bonds into capital goods, securities, or housing but also the shift from war savings bonds into consumer goods of all sorts.

If restrictions were imposed on the redemption of war savings bonds in an attempt to control a postwar boom, there might be an unfortunate delay after the collapse (if Congress were not in session) in getting restrictions removed.

tion is a larger deficit and that the deficit should be produced in the main by large public works.[1] For the time being, labor's great political influence may cause it to support the combating of deflation by rather mechanical and oversimplified fiscal policies, with the result that attacks on deflation are less effective than they might be.

VIII

After the shift from war production to civilian production has been completed—say 2 to 5 years after the conclusion of hostilities —the country will face the problem of maintaining high level and stable employment. This means avoiding both a belated boom and a creeping deflation. How will the spread of labor organization and the shift of bargaining power to labor, accentuated by the war, affect these problems? Again, it is convenient to distinguish between labor's economic policies and its political policies.

The spread of labor organization which has been accelerated by the war represents one of the greatest shifts of economic power in history. It greatly increases the ability of employees to appropriate the gains of successful ventures and of technological progress. In the absence of labor organization these gains would be passed on sooner or later to consumers.[2] Unless the shift in bargaining power produces a sufficient rise in the rate of technological discovery, it is reasonable to suppose that the prospect for profits is reduced by the capacity of unions to convert all or part of the proceeds of successful ventures into higher wages. Consequently, the investment function shifts with the bargaining power of labor. So also to some extent does the distribution of income and hence the propensity to consume, although the evidence points to the conclusion that the distribution of income is surprisingly little affected by changes in labor's bargaining power.[3] Hence we may

[1] Public works, of course, are of special interest to the building trade unions.

[2] Thus the spread of labor organizations may be expected to modify the pattern of price and wage movements, causing wages to climb to unusual peaks in the particular industries and enterprises in which technological progress is greatest and limiting the transmission of the gains of technological progress to the community as a whole. Consequently, labor organization may limit in some measure the effect of competition in socializing the gains of progress. But labor organization is likely to stimulate technological research and thus to increase the gains to be socialized.

[3] Between 1929 and 1939, labor, through the spread of organization and the help of the government, succeeded in raising hourly earnings in manufacturing

conclude that for every distribution of bargaining power between employers and workers there is a different investment function, a different consumption function, and a different schedule of liquidity preference. There is nothing to assure that the distribution of bargaining power between employers and workers will be such as to make possible a high level of employment. Hence is it not likely that the gains of labor organization during the war will produce unfavorable shifts in the investment function and in the schedule of liquidity preference and thus aggravate the problem of maintaining full employment and a high standard of living after the war?

This question seems to require an affirmative answer. Nevertheless, the chances are good that the new distribution of bargaining power may produce no serious general problem for at least a few years after the war—possibly not before 10 or 15 years. It was stated in an earlier section that the war will leave an enormous quantity of technological discoveries to be exploited and that it will produce a substantial jump in industrial research. In fact, it would not be surprising if the outlays for technological research in 1945 were double those of 1940. Both the war's legacy of discovery and its effect on the size of research organizations will produce favorable shifts in the investment function.

Added to this is the probability that even an unfavorable investment function will be offset for some years after the war by an abnormally high propensity to consume. At least this will be true if the control of prices during the war and immediately after is reasonably effective. There will be large quantities of war savings bonds to be converted into goods. Even if the increase in tax revenue and in the sales of war savings bonds far exceed present estimates, demand deposits by the middle of 1943 are likely to be $45 billion or more, and, by the middle of 1944, $55 billion or more. At the end of 1929, demand deposits were $16.4 billion and when the war started about $27 billion. If price controls limit the rise in the level of prices to not more than 60 or 75 per cent above 1939, demand deposits will be abnormally high in relation to incomes and

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by about 22 per cent. In other branches of industry the rise was less, probably about 15 per cent. In the same period the cost of living dropped 15.6 per cent. This means that the purchasing power of an hour's work in manufacturing rose about 43.7 per cent and in other parts of industry about 36.1 per cent. Despite the rapid rise in real wages, the share of private wages and salaries in income produced by private industry rose only from 61.3 per cent in 1929 to 62.6 per cent in 1939, and 63.1 per cent in 1940.

prices. A large and sudden attempt to shift from cash to goods would produce a boom and a collapse. If such attempts can be prevented, the large volume of demand deposits would tend to stimulate a steady increase in production. Eventually, of course, the expansion of production and the rise in prices would eliminate excessive liquidity. While this adjustment was going on, labor might possess great power to appropriate profits without seriously limiting the volume of employment. The warning should be repeated, however, that, after the outlook for profits becomes too unfavorable, surplus liquidity disappears very rapidly.[1]

After the effect of the war upon the rate of technological change has worn off, and after money incomes have been brought into normal relationship with the volume of cash, will not the great bargaining power of labor prevent the attainment of full employment and thus limit the standard of living of the workers? This is a possibility. One may argue that the maldistribution of bargaining power cannot become very extreme, partly because gains in labor's strength will stimulate counterorganization by employers and partly because the bargaining power of the workers is limited by the unemployment which itself is a result of the bad distribution of bargaining power. Support for these arguments may be derived from the experience of Britain and Sweden and to some extent from the United States. One may argue also that the ill effects of a maldistribution of bargaining power are not likely to be serious because the very gains in labor's power stimulate technological discovery.[2] The fact remains, however, that there is nothing to *assure* that the distribution of bargaining power between employers and workers will not produce a large amount of chronic unemployment. Perhaps it will not, but possibly it will.

The basic difficulty seems to be that the customary bargaining units, the enterprise, the region, or the industry, are too small. They do not permit employers and workers to take account of

[1] When would-be investors believe that the chances of loss are greater than the chances of gain, their appetite for cash becomes enormous. Furthermore, a dark economic outlook causes consumers to cut consumption and to build up holdings of cash. Thus unfavorable shifts in expectations produce unfavorable shifts in *both* the investment function and the schedule of liquidity preference.

[2] The distribution of bargaining power which is best depends, of course, upon the yardstick which one uses. The distribution which is best from the standpoint of employment is not necessarily the one which produces the most rapid rate of technological change and, therefore, after several years, the highest standard of living.

the full effect of their decisions upon the general level of employment. Furthermore, the available evidence points strongly to the conclusion that for the nation as a whole the conditions which make possible the largest pay rolls also make possible the largest profits. Profits and pay rolls almost invariably move upward and downward together, and in such a way as to suggest that for each change of 1 billion in the prospect for profits there are corresponding changes of about 2 to 5 billions in the amount which employers are willing to pay for labor. The greatest possibilities of collective bargaining, therefore, will probably not be achieved until representatives of labor as a whole and of business as a whole are able to fix the broad outlines of a national wage policy. A wage policy, in order to be truly national, would need to reflect the interest of labor as a whole in the largest possible pay rolls and of business owners as a whole in the largest possible profits.[1] Only if bargains in the several plants and industries conformed to a national wage policy designed to maximize pay rolls and profits, would the organization of labor no longer threaten to produce an unfavorable shift in the investment function, a high preference for cash rather than for ownership of shares in industry, and chronic unemployment.

The happy stage in which collective bargaining is really based upon the national interests of capital and labor will not be easily or quickly reached. The struggle of individual employers and groups of employers and of individual unions to use their bargaining power in their own way and to their own particular advantage regardless of the effect upon the nation as a whole will be stubborn and persistent. Let us remember that never yet have employers permitted national interests to govern the setting of import duties. And yet so long as bargaining is conducted by rather small autonomous units (enterprises, sections of industries, or industries), it is not so much a method by which workers gain wages at the expense of employers as a method by which each of many thousands of small groups of workers limits slightly the employment opportunities of all workers. Once the day is reached, as it eventually will be, when the broad outlines of a national wage policy are fixed for the purpose of producing the largest possible pay rolls and profits, relations between employers and workers will undergo a revolu-

[1] In other words, the mere fact that the policy was made in a national conference would not make it national in reality. It might be merely a compromise by which the interests of some groups were advanced at the sacrifice of the largest possible national pay rolls.

tionary change and the basis will be laid for cooperation between them in promoting expansion and technological progress—a cooperation which will give the economy far greater power to raise production than it has ever possessed.

IX

The long-run outlook for employment will be affected also by the political policies of the labor movement. Of special importance will be the stand of organized labor upon international economic policies and taxation.

The unprecedented shortages of goods all over the world created by the war will provide a golden opportunity to reverse the trends of the last two generations and to start a movement to reduce barriers to trade. A substantial reduction in trade barriers would open many investment opportunities for American savings and thus would increase employment opportunities and raise living standards in the United States. The world needs equipment of all sorts—automobiles, agricultural implements, diesel engines, gas engines, mining machinery, electric power equipment, railroad equipment, airplanes, textile machinery, refrigerating machines, printing presses. If the United States is to supply the world with equipment on a large scale, it must be willing to take goods in exchange. This does not mean a dollar's worth of imports for every dollar of exports. Rather it means, for the time being, accepting perhaps $1 increase in imports for every $2 or $3 increase in exports—sufficient to provide an adequate return on foreign investments and possibly some amortization. In the course of time, as our foreign investments increase, we shall gradually develop an import surplus.

In order to help foreign nations pay a return on new American investments abroad, the import duties of the United States, which in the course of 150 years have reached fantastic heights, must be substantially lowered. The best opportunity to do this, or its equivalent, will be shortly after the war when rates of exchange are established between the dollar and various foreign currencies. If the rates of exchange are made more favorable to foreign countries than were the prewar rates, (if the pound, say, is eventually priced at about $3.50 or $3.75), that will be equivalent to a reduction in our duties.

The farmers of the country, with the exception of the cotton growers, are irreconcilably protectionist and will oppose participation by the United States in a general movement to reduce barriers

to trade. Whether the policy of the United States is restrictionist or anti-restrictionist will depend, therefore, in the main upon whether organized labor supports the cotton farmers in favor of freer trade or the wheat, dairy, fruit farmers, the wool and sugar raisers, and the cattlemen in favor of trade barriers. The interests of most industrial workers (with the principal exception of most of the textile workers) will be promoted by freer trade. This will be especially true of nearly all workers in the metal trades. The traditional view of American labor, however, has been protectionist. It has feared the so-called *pauper labor* of Europe and Asia and has supplied the votes that kept the industrial Northeast protectionist. Hence labor will experience a clash between its traditional views and its current interests. Eventually its current interests are bound to win over its traditional views, but time may be required for this to happen. Just when labor's support is most needed to enable the United States to participate in reducing the barriers to trade, that support may be lacking. If it is lacking, the labor organizations will lose a golden opportunity to raise the standard of living of their members and of workers all over the world.

X

During the last 10 years the Federal tax system has developed in such a way as to bear heavily upon profits, to produce an unfavorable shift in the investment function, and to limit employment opportunities. Even in 1940, Federal income and excess profits taxes took $2.5 billion out of $9.5 billion of corporate income before taxes. Furthermore, the government has developed a strong propensity to tax profits, with the result that one may expect almost any new revenue need of the government to be met by stiffer taxes on profits. The possibility that large and more or less unforeseeable taxes may be imposed upon profits is bound to have most unfavorable effects upon estimates of prospective returns and, therefore, upon the volume of investment and of employment. With the necessity of meeting a postwar budget of roughly $17 billion, the kind and amount of taxes levied by the Federal government will be of first importance. Drastic changes in taxes, especially in taxes on profits, will be necessary to permit the community to have the amount of enterprise which it needs. Furthermore, in order to prevent tax policy (or lack of tax policy) from producing an unfavorable investment function and, therefore, from limiting employment opportunities, the principle needs to be firmly estab-

lished that increases in taxes on profits will be made only as a last resort.[1]

Up to the present, organized labor has taken little interest in taxes on profits. Labor has assumed that such taxes did not fall on labor and that they might even prevent the passage of taxes which would fall on labor. Sooner or later labor will discover that it has an even greater interest in taxes on profits than do business owners, for the simple reason that a change of $1 in the prospect for profits produces a change of several times that amount in pay rolls. Labor does not know this fact yet, but labor cannot be expected to remain ignorant of it forever. Possibly labor will not discover its interest in taxes on profits in time to get its interests effectively represented when tax reductions and changes in tax laws are made within a few years after the war. If labor does not, the country will be severely handicapped in its efforts to maintain a high level of employment after the shift to civilian production. Continuation of the Federal tax policies of the last decade are incompatible with an economy in which a spirit of enterprise and adventure flourishes. Without the support of organized labor the country will probably not be able to establish a tax system which is carefully and skillfully designed to encourage enterprise and thus to promote a high demand for labor.

XI

The rise of trade unionism will accelerate the revolutionary change in government represented by the shift of policy making from legislatures to administrators. This gradual supplanting of legislative government by administrative government has been going on in all democratic or quasi-democratic countries for over a generation. It has been speeded up by the great depression and by the two world wars.

No one knows whether the rise of the administrators and the decline of the legislators will help or hinder the realization of democratic ideals, *i.e.*, the creative participation of large numbers of people in making ethical systems and in selecting policies and men to implement the ethical systems. For a generation or two the rise of administrative government may be harmful to democracy because the public may require time to convert the administrators from masters into servants.

[1] For other guesses concerning postwar budgets see the papers by Hansen, Bissell, and Harris in this volume.—EDITOR.

Whether the revolution in government is immediately good or bad for democracy, the leaders of labor will support it because the new kind of government enhances the power of the national union leader and makes it easier for him to participate in the process of policy making. Certainly, it is much easier and more satisfactory for a union leader to present views on policy to administrative officials than to committees of Congress. If the administrator agrees with the union leader, he can modify his policies immediately. Even if the Congressional committee agrees with the union leader, action will be slow and nothing may happen anyway. In other words, the very conditions which are producing the revolution in government, the fact that the administrators are usually better informed policy makers than the legislators and better able to act quickly, will cause labor leaders to support the revolution. In most of the clashes between Congress and administrators, the union leaders will be on the side of the administrators. The preference of labor leaders for administrators or legislators will, of course, change with political shifts, but in the long run the union officers are likely to support the administrators more often than the legislators. A principal reason for this belief is that the administrators are gradually learning how to gain support from labor leaders by making regular consultants of them and giving them a wider voice in public policy making.

XII

The great impetus given to the growth of labor organization by the war will confront employers, unions, and the public somewhat earlier and in more urgent form with many problems which otherwise they would have been compelled to face somewhat later. The great spread of unionism will produce a change in the nature of unions and will cause them to become quasi-public organizations. Up to now unions have been very private affairs, free to admit or expel men as they saw fit and to run their own affairs as they (or their leaders) desired.[1] In a few instances, unions have virtually been the private property of a few leaders. Public policy toward

[1] The worldwide tendency for administrators to gain power at the expense of legislators extends to the internal life of trade unions. The adjustment of the internal business methods of unions so as to preserve a reasonable amount of democracy in unions will be a principal problem of trade union government during the next generation.

the internal operation of unions has been one of *laissez faire*. Obviously, organizations which control employment opportunities in great industries and which can deprive men of an opportunity to make a living in those industries cannot remain private. They must keep their doors open on reasonable terms to all reasonably qualified men who may wish to join. New York State recently passed a law forbidding unions from refusing membership on the ground of race, color, or creed. A few organizations still draw the color line and a few restrict membership by stiff initiation fees. Such restrictions need to be removed.

Important also is control of the imposition of discipline by national unions—discipline of entire locals or districts by putting them in "receivership," and discipline of individuals by the imposition of fines or by expulsion. Such control is necessary in order to protect the democratic process within unions and to make unions effective instruments for industrial democracy. "Receiverships," by which nationally appointed representatives supplant for the time being the elected representatives of the local, are from time to time necessary.[1] In some cases, however, they are simply used to remove from office effective critics of the national union administration. Furthermore "receiverships" may be continued long after they are needed. There are instances of "receiverships" lasting 20 years.

The most satisfactory arrangements for protecting the integrity of democratic processes within unions would be for the labor movement itself to establish a judicial body to which locals might appeal for the removal of "receiverships" and to which individual union members might appeal cases of expulsion, suspension, or fine.[2]

[1] They may be necessary because indifference of the members has permitted irresponsible or corrupt leadership to gain control of the local, because an extreme growth of factionalism prevents the local from functioning effectively, or because of other reasons. In every instance, the "receivership" should have the purpose of restoring ordinary democratic processes as soon as possible.

[2] Appeals in some cases of union discipline might be to the umpires who hear discharge cases arising under trade agreements. A closed-shop contract gives the union the opportunity to discharge men by expelling or suspending them or by imposing a fine which they are unable to pay. If men have the right to appeal to an umpire when they are discharged by the employer, they should have the same right when they are discharged by the union. Such right is given under a number of agreements. Employers should not sign closed-shop agreements which do not provide for an open door into the union and for appeal to a neutral umpire in cases of discharge, whether the discharge is made by the employer or by the union.

This would not be an easy step for the labor movement to take because it would conflict with the strongly established tradition of union autonomy. This tradition, however, seems destined gradually to be modified. If the labor movement does not act, the government undoubtedly will. The National Labor Relations Board might be authorized to determine whether the principles of fair representation require the removal of a "receivership" and to hold an election where it considers its supervision necessary to protect the rights of the members of the locals. Likewise, the board might be given authority to receive appeals from severe discipline by unions (cases of expulsion, suspension, or large fines, say $100 or more) except where appeal to other neutral agencies is provided by the union constitution or by agreements with employers. The regulation of the internal life of unions by government agencies, if abused, can easily become a threat to the integrity of the democratic process in the community at large. Consequently, it is to be hoped that the unions make such regulation unnecessary.

Problems are also presented by the terms of trade agreements. The community cannot always rely upon the opposition of interests of employers and workers to exclude from trade agreements provisions which are contrary to public policy. Consequently, the community must work out general principles by which to determine whether or not the provisions of trade agreements conflict with public policy; and it must work out procedures by which to obtain modification of agreements which conflict with public policy. To take a simple but fundamental question: how far should trade agreements be permitted to restrict the making of technological changes or the use of new materials or new methods? To particular groups of workers and employers certain technological changes may be injurious, and a trade agreement may place stiff impediments against these changes. For the community as a whole, however, technological changes are the only hope of producing large improvements in the standard of living. Furthermore, such changes are needed to produce sufficient investment opportunities to yield full employment. Which shall prevail: the security of the community that requires technological change to prevent unemployment, or the security of the small group that will suffer loss of jobs if methods are changed? If the community decides that its interest must prevail, by what equitable and practical methods can the public policy be implemented?

XIII

By far the greatest question presented by the gains of labor is whether unions will prove able to assume the responsibilities that go with great power. Until recent years the labor movement in the United States has been small and weak. It has had an uphill struggle for existence against tremendous odds. Naturally, it has had the psychology and also the problems of the underdog. Unions did not worry about unduly encroaching upon the profits of employers, or about limiting the amount of enterprise (and hence the amount of employment) in the community. Organizations fighting for bare existence do not consider such problems.

Today very few unions are underdogs. Some of them are even overdogs. The others are quite powerful enough to take care of themselves. Within broad limits, they now determine the amount of enterprise in the community. If they overreach themselves, they injure both employers and their own members. Because of their great power, unions will defeat their purposes unless they show concern for the profits of employers and the prosperity of industry, unless they become in large measure guardians of enterprise. To the pioneer fighters in the battle of the unions for survival, such a policy would seem a betrayal of the labor movement. And yet there is no escape for the unions. If their policies really do determine in large measure the amount of enterprise, they must either take account of this fact in formulating their demands or they must become instruments for limiting rather than raising the standard of living of their members.

As indicated in a previous section, the great power which unions are acquiring, and the necessity of their taking account of the interests of labor as a whole, require a change in the structure of the labor movement and in the methods of making the policies. The problem of developing a structure within the labor movement which permits policies to represent the interests of labor as a whole, rather than the interests of carpenters, steelworkers, or plumbers, is simply a part of the general problem which confronts the community as a result of the rapid rise of group organization during recent years.

The nineteenth century developed the theory that history is to be interpreted mainly as a struggle between classes and groups. That doctrine has much historical truth. But a better organized and harder fought struggle among farmers, manufacturers, wage

earners, retailers, pension seekers, veterans, and others offers no promise as a way of raising the standard of living. It would be sheer accident if the struggle produced the distribution of income and of economic advantage which makes possible full employment and the largest volume of output of which the working force and the plant are capable. And the uncertainty in the position of each group, particularly business owners, which is an almost inevitable result of a vigorously conducted struggle, would have an unfavorable effect upon the investment function. The achievement of the conditions most favorable to full employment and a high standard of living, therefore, requires cooperation among organized groups for that purpose. It is the task of the twentieth century to make group organization the instrument of constructive cooperation rather than of destructive conflict. Organized labor will be able to make a major contribution to intergroup cooperation provided it develops the capacity to think in terms of the national interests of labor rather than simply in terms of the interest of small groups.

CHAPTER XV

POSTWAR SOCIAL SECURITY

EDWIN E. WITTE

The term *social security*, in the connotation it now has, is of American origin and less than 10 years old. It did not gain wide currency until the House Ways and Means Committee in 1935, looking about for a title distinguishing the substitute bill it reported for the Administration's "Economic Security Bill," hit upon the "Social Security Act," for no particular reason. Ever since, the term has been applied to everything included in this important Federal law and to other similar institutions.

Today *social security* is an immensely popular term, not only in the United States, but throughout the British Dominions and in other lands as well. In Article V of the Atlantic Charter, President Roosevelt and Premier Churchill proclaimed "improved labor standards, economic advancement and social security for all" to be one of the major postwar objectives of the two great English-speaking nations. In the United States, both major political parties are pledged to the "extension of social security." In England, Ernest Bevin recently said: "I suggest that at the end of this war we accept social security as the main motive of our national life"; and the same view has been expressed by Anthony Eden and Lord Halifax. Elsewhere the term is not so well established, but it is gaining acceptance in Latin America and is at least understood by informed people throughout the world.

Yet this term lacks precise meaning even in the United States. The most widely prevalent usage is that adopted by the International Labour Office,[1] which includes within the term both *social assistance* and *social insurance* and also *social security systems.* Social insurance systems "represent an integration of social insurance and assistance." Social assistance stems from the old institution of poor relief and "expresses the obligation of the community

[1] International Labour Office, *Approaches to Social Security: An International Survey* (Montreal, 1942), pp. i, ii.

toward its needy members." It includes noncontributory pensions for the aged and for invalids (the American *old-age assistance* and *aid to the blind*), mothers' pensions (in statutes called *aid to dependent children* in this country), unemployment assistance, medical assistance, and rehabilitation of the disabled. Social insurance, in contrast, "is situated between social assistance and commercial insurance." It is established by law and serves social purposes but utilizes insurance principles. It first made its appearance in Europe in the 1880's. Its foundations were, not poor relief, but the employer's liability principle, voluntary sickness funds, and pension funds for small groups in the population, such as civil servants, miners, and seamen. Today it includes workmen's compensation (or industrial accident insurance), sickness (or health) insurance, old-age, invalidity, and survivors' insurance (called *pensions* in Europe), and unemployment insurance.

As thus defined, *social security* is broader than social insurance, although the latter term is often loosely used to include social assistance and integrated social security systems. It is narrower than the English *social services* and the Scandinavian *social policy*, which include, besides social security institutions, such other governmental services as public education, public-health and medical services, public housing developments, and still other publicly financed and directed programs for the benefit of people in low-income groups. It is also narrower than *economic security* or *security*, as economists use these terms. The social security approach is basically that of individual and family welfare. Its concern is with the immediate hazards that spell want and dependency to many individuals and families, not with ultimate causes or basic reforms.

As thus conceived, social security has but limited values. It is not a panacea, nor a cure for any of the conditions it seeks to relieve. Yet it serves vital needs of society. Without maintenance of individuals and families in all contingencies of life, the hope of fundamental remedies for economic ills is but illusory.

For this reason, relief is as old as is civilization. In this day and age, it is predominantly a responsibility of the state. Social assistance is specialized relief, adapted to the needs of clearly distinguishable groups among the people without adequate means for individual or family maintenance (not mere subsistence, but a level of maintenance compatible with prevailing concepts regarding the needs of the beneficiaries of the several programs). Increasingly,

social assistance has come to include not merely cash grants for maintenance, but health and other services designed to reduce the need for assistance in the future.

Social insurance serves, basically, the same purposes. Through social insurance, the costs of meeting the economic hazards whose consequences are want and dependency are reduced from the maximum costs which the individual must be prepared to meet if he does so on an individual basis to the average costs of affording protection. Like private insurance, social insurance serves as a method of distributing the costs of meeting economic risks over large numbers of people and over periods of time appropriate to the particular hazard. In addition, it has some distinctive advantages which private insurance does not have. It is generally compulsory, which ensures normal distribution and reduces costs. In social insurance, also, only part of the costs fall on the insured, the balance being met through contributions from the employers or the government or both. These characteristics make social insurance peculiarly valuable to people with small but fairly stable incomes. From society's point of view, moreover, its values do not lie solely in the fact that it affords insurance protection to many people who otherwise would have little or no insurance. It has important repercussions on the economic system and can be utilized for socially desirable ends beyond those of providing insurance protection for the masses. In theory, the large reserves, which are no less necessary in social than in private insurance, can be so managed as to increase the stability of the economic system. At least some forms of social insurance can be set up in such a way that they will operate as a strong stimulus to preventive efforts, thereby lessening the seriousness of the hazards against whose economic consequences they are designed to provide protection.

Yet the great extension of social security in recent years and its present immense popularity are not due solely to its intrinsic values. In large part, this is but one manifestation of the broader quest for security which, in all industrially mature countries, has become the economic objective of the great majority of the people. The factors which have led so many people to value security above opportunity cannot here be discussed. Suffice it to repeat that this is the age in which people in all walks of life are searching for security. Seniority rights in jobs, guaranteed employment, restrictive union rules, parity prices for farm products, the open-price practices of trade associations, the "live and let live" policy

pursued by businessmen toward competitors, the growing number of licensed occupations, and the great concern of economists over economic fluctuations are only a few of the many illustrations of the ever-growing present-day interest in security. Social security is but another manifestation of the same phenomenon. It is the quest for security on the personalized level of the common man and the everyday family. Some people may see in it far more of danger than of promise, but it is a natural, if not inevitable, development in the day and age in which we are living.

Poor relief is as old as is civilized society. In this country it dates back to the earliest days of settlement. The institutions out of which social insurance developed in Europe antedated the nineteenth century. Social insurance itself and specialized forms of relief now known as *social assistance* first developed in the last decades of that century. In the United States, aid to the blind, aid to dependent children, and workmen's compensation, our first form of social insurance, all were started before the First World War. Out of that war we got vocational rehabilitation and public medical care for veterans, and in the twenties old-age assistance. In Europe, the decade following the war was that of the most rapid progress in social insurance. In this country, the great spurt did not come until the thirties, when want and dependency became the lot of many millions of American families. In the depression we passed the Social Security Act, and in the space of a few years registered the greatest growth in social security institutions ever recorded in any country. When the Second World War began in 1939, we had all forms of social security known in Europe except health insurance and disability insurance. Our social assistance payments were the most liberal in the world. In a decade, our expenditures for social security purposes increased more than twentyfold. Yet we had by no means satisfied the popular demand.

In the present war, social security has been pretty much at a standstill in the United States. In his message recommending passage of a selective service law, the President urged Congress to include provisions for the protection of the social security rights of workers called to the colors, but no concrete plan for doing so has ever been presented. At the present writing (late in 1942), this country is the only major belligerent which has failed to protect its service men in this respect. In January of this year, the President, in his budget message, recommended increase of the rates of the social security taxes, the extension of coverage of the old-age

insurance system, the establishment of a national system of disability and hospital insurance, and the liberalization of unemployment insurance under standards to be established by the national government. But the promised detailed Administration proposals to give effect to these recommendations have not yet made their appearance. A plan for war-displacement benefits to supplement unemployment insurance was brought forward soon after the President's message, but did not even get out of committee, because it aroused fears that it was designed to federalize unemployment compensation. Less than a month before Hitler started the shooting war and in face of warnings that this nation would soon need all the revenues it could get, Congress reduced the social security taxes. Since Pearl Harbor, Administration leaders have repeatedly urged that the social security taxes be increased, but Congress has been deaf to these recommendations. Numerous bills to extend and strengthen our provisions for social security are pending in Congress, but none of them have been even accorded a hearing, except the Downy bill for a flat pension of $30 per month to everybody over sixty-five (a modified Townsend plan), which was favorably reported by a special committee but which the Senate refused to swallow.

A very different story is to be told for other countries.[1] Beginning with England, it is to be noted, first, that the rights of men called to the colors have been preserved, as to both old-age and health insurance. To meet the costs of providing this protection a small deduction is made from the soldiers' pay, but the Treasury defrays most of the expense. Similarly, the government has assumed responsibility for medical and hospital care for civilian war victims and, in connection with this service, has given financial assistance for hospital improvements and extensions. It also has undertaken large social service programs to meet needs peculiar to the war, such as the feeding of school children, communal food kitchens, and subsidies to the producers of essential foods, to make certain that people in low-income groups will be able to get these foods at prices they can afford to pay.

In addition to these wartime innovations, quite extensive changes have been made in the old social security institutions. In

[1] The information in this and succeeding paragraphs about developments in the social security field during the war comes mainly from the *International Labour Review*, published monthly by the International Labour Office, whose headquarters are now at Montreal.

all the social insurance systems—health insurance, old-age and survivors' insurance, unemployment insurance, and workmen's compensation—coverage has been extended and benefits and contributions increased. Since the war started, the unemployment insurance fund has finished paying off its debt to the Exchequer and is now trying to build up a large reserve for meeting the situation of mass unemployment with which it is again likely to be confronted after the war. In the social assistance programs, benefits have been increased to keep pace with increases in the costs of living and a long-standing grievance of the working people has been corrected through the abolition of the household means test and the substitution therefor of a family and individual basis for determining need. Unemployment assistance, through which, since 1935, the national government has assumed responsibility for all relief necessary to workers normally regularly employed in industry, has been extended to include all pensioners and has been renamed "public assistance." Finally, the government has recently organized an Interdepartmental Committee on Social Insurance and Allied Services to consider how a unified social security system may be developed after the war.[1]

For other parts of the British Empire, similar developments are to be recorded. Canada established a national unemployment insurance system which came into operation on July 1, 1941. It has also adopted a comprehensive plan for the restoration of discharged soldiers to civilian life, which includes payments by the government to the unemployment insurance fund to give all service men the same rights under the unemployment insurance system as if they were in private employment, and special grants if, during the first 18 months after their discharge, they become unemployed and exhaust their unemployment compensation benefits. New Zealand, likewise, gives its service men the same credits in its social insurance system for time spent with the military forces as they would get in private employment, with the government paying the entire costs, and it has organized a National Rehabilitation Council to make plans for the restoration of the service men to civilian life when the war ends. In Australia, the Commonwealth in July, 1941, set up a Joint Parliamentary Committee on the Improvement of Social Legislation and Social Conditions, charged

[1] This committee has issued the Beveridge Report, which provides for a comprehensive program of social security. This report has been published by Macmillan here and is having a significant influence in the United States.—EDITOR.

with the duty of developing a coordinated plan for social services. In an interim report made by a committee late in 1941, it took the position that in view of the federal system of government which exists in Australia as in the United States the best results could be secured "if future services are to be administered on the basis of Commonwealth-State cooperation," with grants-in-aid to the states by the Commonwealth for social services "to be administered by the States on lines laid down in Commonwealth legislation." It also announced that it expected at a later date to make recommendations for a Commonwealth Social Security Act. More recently, the Commonwealth government has asked the committee to make a special study of the feasibility of unemployment insurance, and it has been giving a great deal of attention to a national plan for public medical services.

Very notable also has been the progress of social insurance in the last few years in the Latin American countries. Costa Rica and Peru in 1941 enacted comprehensive social insurance laws, which include all forms of social insurance except unemployment insurance. Brazil has extended its previously very limited pension insurance system to substantially all employees except agricultural workers, and, under it, affords combined old-age, invalidity, and survivors' insurance protection. In both Argentina and Mexico, governmental commissions are at this writing engaged in studies looking toward the establishment of comprehensive social security systems. There has also been organized, at the instance of the International Labour Organization, a Social Insurance Commission of the American Countries, to assist the participating countries in developing social security systems on a coordinated and sound basis.

In enemy countries, particularly in Germany, there also have been important developments affecting social security. Not only has Germany provided that men called to the colors retain all social security rights without cost to them, but their dependents are automatically included in health insurance. Additionally, health insurance has been extended to war widows and orphans and to all pensioners, and its benefits have been liberalized, particularly by the medical-care services. There also has occurred some extension of coverage and liberalization of benefits in accident insurance and in old-age, invalidity, and survivors' insurance.

These developments do not differ fundamentally from those in the free countries, but something radically different is foreshadowed

in the announcement made by the government, early in 1942, that it is working on a plan for a universal pension system, which will include all the German people and which will be based on National Socialist principles, and not on the social insurance concepts of the "plutocratic-democratic countries." What appears to be contemplated is to make old-age, invalidity, and survivors' insurance a direct government obligation, but with all payments based on need, rather than right. In unemployment insurance such a transition has already been effected. Since the beginning of the war, no one in Germany has gotten unemployment insurance as a right, but payments have been made only to unemployed workers on a basis of their actual needs. The old contributions from employers and employees, averaging a combined 6.5 per cent of pay rolls, have been retained but are now commingled with other government funds. Thus, while Germany has been extending its social insurance institutions, it has also been remaking them in accordance with the Nazi philosophy and what they are developing is something very different from social security as known elsewhere in the world.

In the countries overrun by the Nazis, the established social security institutions have been nominally continued. From such scattered information as is available about the actual situation, however, it would appear that for most of the conquered people, at least, loss of freedom has also meant loss of all social security protection.

These wartime developments forecast what is likely to be the future of social security. Should the Axis powers win the war, there will be no social security worth discussing in any of the defeated nations. For the white and yellow "Aryans," also, social security will not be a right, but a payment which the government may withhold at any time.

Assuming the victory we still have to win, great advances in social security are to be anticipated. Precisely what will be done in each country to give reality to the pledges made by the political leaders of social security for all, it is, of course, impossible to say. But something of the probable lines of development can be forecast, if past trends, current needs, and popular demands are correctly appraised.

Dealing in this forecast only with the United States, it is of but slight significance that we have been laggard in the adaptation of social security to war conditions. It is unthinkable that this

country will not protect the social security rights of the men it calls to the colors. Before the war ends national legislation to accomplish this purpose will be passed. The fact that this has not been done to date may create injustices in a few cases, involving men discharged during the war, but for the great majority of the service men it will be timely if such legislation is passed before the war ends. And we may hope that this country will deal with the men who are risking their lives in its service as generously as have other belligerents, allowing them the same credits as if they had been in private employment, without requiring any contributions from them.

Very probable also is legislation before the war ends to facilitate the return of the demobilized service men to civilian employment. The provision which is included in the Selective Service Act that the drafted men are to get their jobs back if they still exist will not alone prove sufficient. We shall have need for expanded vocational training services and educational bonuses and, probably, also for cash payments to men who cannot find jobs or hold them, which should be conditioned upon participation in training programs designed to make them more valuable to industry.

The problem of demobilization after the war, of course, will involve much more than merely the return of the service men to civilian life. It includes also the problem of transferring many millions of workers from war production to production for peacetime needs. This is likely to be accompanied by much unemployment and clearly will necessitate widespread movements of workers and shifts of occupations. This is much more than a problem of social security, but one of its most important aspects is that in the transition period millions of Americans will have low or no earnings and many of them and their families are likely to be in want.

Various proposals have been put forward for meeting this situation. Among these is the establishment of a dismissal wage, to be paid on discharge to the workers no longer needed in war production, either from a social insurance fund or directly by the employers. This proposal has recently been endorsed by the National Association of Manufacturers, but it is not clear whether this organization favors legislation on the subject or merely voluntary action on the part of the employers. To be more than a salving of the conscience of employers who dismiss workers after they have helped them earn large profits, dismissal compensation must be compulsory and a fund should be built up on a contributory basis,

while profits and earnings are good, to ensure payments when needed. The early establishment of such a system of dismissal compensation is much to be desired, but politically it as yet commands little support.

Within Administration circles and also on the part of organized labor, the most highly favored proposal for meeting the social security problems of postwar readjustment is "the federalization of unemployment insurance." By this is meant the replacement of the existing Federal-state system of unemployment insurance (which is really a system of 51 separate state funds, but with a large measure of control over administration vested in the national government) by a unified system, exclusively administered and controlled by the national government. There are many arguments to be made for federalization, as well as arguments against it, but the most popular at this time is that such action is necessary to meet the problem of the expected large volume of postwar unemployment. At the moment, federalization of unemployment insurance has little support in Congress, but it is a distinct possibility that as the war approaches its end and fears develop about the mass unemployment which is expected to accompany postwar readjustments we shall "federalize" our system of unemployment compensation. This cannot be regarded as a certainty, however, because federalization has aroused bitter opposition. Regardless of whether we should federalize unemployment compensation, other measures will clearly be necessary if we are to make the transition from war to civilian production without a large and dangerous increase in want and dependency. There will be need for a planned and controlled transition, assisted migration, extensive retraining, and expanded public works programs, as well as for both unemployment insurance and dismissal compensation. But there is danger that, in the bitterness of the controversy over the federalization of unemployment compensation, little or nothing will be done in preparation for meeting what might be called the human or family aspects of civilian demobilization.

Beyond the period of demobilization lies that of recovery from the ravages of war and of the establishment of a world in which the four basic freedoms will prevail. The basic economic problem will doubtless be that of maintaining full employment, but there will also be many social security problems requiring attention.

Of these it is quite likely that major attention will again be given to old-age security. For the moment, even the Townsendites

are more interested in the war and its outcome than in old-age pensions. Yet the politicians continue to make vague promises of support to the Townsendites. This situation is indicative of the fact that there is much dissatisfaction with the present provisions for old-age security, although as a group the old people are being treated much more generously than any other large element among the poor in our population.

Beyond question the present provisions for old-age security are far from being completely satisfactory. Old-age assistance, which is now and for many years will remain by far the larger part of our total program for old-age security as measured by benefits currently paid, varies greatly in actual operation from state to state and often within the same state. Grants in many areas are miserably small and the conditions under which they are made are deemed humiliating by many of the old people. The greatest defect in the present provisions is that the Federal aid for old-age assistance goes mainly and very disproportionately to the wealthier states. This could be corrected through a system of variable grants, but Congress has refused to accept this recommendation of the Social Security Board. The old-age insurance part of the program also has many defects. It is not financed on an actuarially sound basis. The so-called *dependents' benefits* which it provides are illogically set up and the survivors' benefits are very limited. Most serious of all, large groups in the population are excluded from coverage, and under the present law at least one-third, and probably more, of the people who are covered for tax purposes will never be able to qualify for benefits.

In trying to forecast what is likely to happen after the war, account needs also to be taken of popular feeling in relation to old-age security. Most important in this connection are the widespread sentiment that all Americans should enjoy old-age protection and the belief that excessive reserves are being collected and that much larger benefits might be paid without any increase in contributions. Out of these popular beliefs arises the danger that after the war we may replace our present contributory old-age insurance system with a "baby Townsend plan"—a flat pension payable to all old people regardless of need. Such a program would either prove financially impossible ere long or become something closely akin to the German *Volksversicherung*, under which everybody would be taxed for old-age insurance purposes but only the people in need would get benefits. Yet it is quite likely that

we shall experiment with a baby Townsend plan, unless very soon we extend the present contributory system to include all our people and correct the injustices and anomalies which now exist in both old-age assistance and old-age insurance.

But urgent as is the need for betterment of the present provisions for old-age security, there is equal, if not greater, need for more adequate protection against other social security risks. Of these, health and disability are among the most important.

Besides China and India, the United States is the only major country in the world which does not have a national health insurance law. There have been two periods of great interest in compulsory health insurance in this country, 1915–1920 and 1932–1939, but neither resulted in the passage of such a law in any state. Very considerable progress has been made in recent years in voluntary medical care and, particularly, in voluntary hospital insurance. But compulsory health insurance seems remote. While endorsed by organized labor, farmers' organizations, and women's clubs, there are but few people who are very much interested in it, while organized medicine fights it relentlessly as "socialized medicine."

In the meantime, actual socialized medicine—medical care at public expense—has increased at a rapid pace. Medical care, in the United States as elsewhere, has long been furnished under a mixed system of private and public care. During the depression and still more in wartime, the public part of this mixed system has become increasingly important. It is probable that this trend will continue. One reason for expecting this is that the veterans of the present war will doubtless get medical care very largely at public expense for the rest of their lives, as did veterans of the last war. There is also reason to expect that the American people will in the near future manifest much more concern than they have done to date over the large number of rejections for physical reasons in the draft, which, while not indicating lack of progress since the last war, nevertheless reveal that many Americans suffer from curable and preventable diseases, largely because they lack sufficient income for adequate medical care.

Equally clear, if not more so, is the need for social insurance institutions to provide income in replacement of lost wages, in cases of illness and permanent disability. In most countries the former is provided through compulsory health insurance, the latter in connection with old-age insurance.[1] In this country, because

[1] In England, as a part of health insurance.

compulsory health insurance has met with such violent opposition from the doctors, the Social Security Board has proposed that compensation for both temporary and permanent disability be administered along with old-age and survivors' insurance. It was hoped that such a program would be acceptable to the doctors, but organized medicine, while not unqualifiedly opposed, seems fearful that anything of this sort will serve as an entering wedge for compulsory health insurance.

The final form of social insurance, workmen's compensation, is seldom mentioned in discussions of social security in this country, but in benefits paid it ranks among the most important of our social security institutions. By and large, workmen's compensation has been a success and is exceedingly popular. But there is need for extension of coverage, liberalization of benefits, and inclusion within its scope in all states of all occupational diseases, along with industrial accidents.

Finally, in relation to social insurance, note needs to be taken of the fact that after the war—possibly even before its close—we are likely to have proposals for a unified social insurance for all contingencies of life. Anything along this line is difficult to work out and is likely to become snarled up in a Federal-state controversy, but it merits attention.

In any reasonably satisfactory social security program, social assistance will have almost as large a part as social insurance. There is need for the improvement of our social assistance institutions in many respects. Particularly if it should prove impossible to get disability insurance, we shall need to consider assistance to the disabled as a new form of specialized assistance. And we clearly need to improve our measures for security for children. With children becoming more valuable in our society as they become scarcer, and with two-thirds or more of all children born in the homes of the poor, it is to be hoped that the American people will ere long come to realize that security for children merits quite as much attention as does old-age security.

In addition to all specialized programs, we shall need to give thought to the leftover group provided for under general relief. In the depression period we spent many times as much for direct and work relief as we spent for all other types of social security put together. Millions of Americans had personal experience with relief, and to but few of them was this experience one that they care to repeat. Almost unanimously, our relief institutions were

regarded as most unsatisfactory. Yet at the end of the depression these institutions were pretty much what they have always been, and we lacked a national program for handling relief. A committee working under the National Resources Planning Board, appointed at the suggestion of the President, studied the problem for nearly 2 years, but its long overdue report has still not been made public. In the meantime the Civilian Conservation Corps has been liquidated, and the Works Progress Administration is gradually being liquidated. But relief is still a very sizable problem and, almost certainly, will be much larger after the war ends. While we cannot be optimistic about what will be done, the development of something like a permanent relief policy is one of our most urgent social security needs.

The program that has been suggested for social security after the war is a large order. Many people will think that it is not financially possible, while others will take the position that it is futile to talk about social security apart from attaining full employment. Both points of view have some merit but are false in their extreme form of statement. Under present conditions, adequate social security can be financed only on a contributory basis, and there are limits to the benefits that can be provided. But social security costs are largely in the nature of a better distribution of costs which society must meet in any event. Our economy, moreover, cannot survive at all unless it satisfies the mass of the people, and social security is their rightful demand. How far we can go toward satisfying this demand will depend upon our total volume of production, but full employment will not eliminate the need for social security. Even when we have what may be technically termed *full employment*, there is much unemployment, and most other hazards leading to poverty and dependency have little or no relation to employment. In the postwar world we must provide reasonably adequate social security protection for all our people in all contingencies of life or we will have dictatorship and chaos.

What forms social security will take in future years is uncertain. In this chapter a conservative program of development has been discussed, but more radical measures are well within the range of possibility. Social security has no meaning apart from the government and the economic and social systems which prevail in a given nation at a given time. Its content and underlying purposes, even its meaning, will change with changes in the government and the economic system. Social security appropriate to our old Federal

system of government, in which there were sharp lines of distinction between the authority of the national and the state governments, is different from that which suits a cooperative or a unitary government, either of which we may be developing in this country. Similarly, social security consistent with an economy of free enterprise differs from social security in a planned economy. The future of social security is unseverably tied up with the future of our government and of our economy and will reflect changes which may occur in those basic institutions. But social security has become an important part of the American way of life and in the years which lie ahead will become increasingly important.

PART VI

Agriculture and Related Problems

Chapter XVI

NUTRITION, FOOD ATTITUDES, AND FOOD SUPPLY

M. L. Wilson

The basic pattern for democratic civilization is that the individual shall enjoy the greatest amount of freedom commensurate with the general welfare of society. To enjoy this democratic freedom, the individual automatically is called upon to move within certain limitations and disciplines through which alone democracy can be assured.

Politically these limitations have, in the United States, been defined by the Bill of Rights and in laws growing out of subsequent statutes and court decisions. Economically the past few generations have seen the development of a definite pattern of economic democracy. But in matters of adjusting ourselves democratically to the rapid progress of science, much remains to be done.

In recent years, we have learned that there are some rigid adjustments—physiological and psychological—which mankind must be willing to make if it wants to enjoy the benefits of the scientific and technological age in which we find ourselves. For man to live and progress with the machine and with science he must accustom himself to a whole new set of disciplines and rules of living, which formerly were more or less determined by natural laws of survival.

A prominent example of how these adjustments can be made, and are made, is found in the field of modern nutrition. Nutritional science has moved forward at a rapid rate in the past 20 years. At the end of the First World War, scientists were talking about two or three vitamins. At the time this is written, there are about thirteen, all of which have been isolated in pure form.

HUNGER AND MAN

Hunger and satisfaction of hunger through food are phenomena as old as man. The biological process of converting food into the

energy and resistance necessary for sustenance, growth, and good health has gone on through the ages. Whether or not individuals recognized the scientific nature of this process, it was there. Today we recognize it. We have a vast new field of knowledge which we speak of as *nutrition.* Everyday eating which contributes to the most favorable growth and health of human beings is called *good nutrition.* Eating which does not meet the minimum requirements for favorable development and good health is called *bad nutrition.*

Through most of man's history, food getting has been a hit-or-miss matter. Hunger has been one of his greatest fears. One of the four horsemen of the Apocalypse is known as Famine. Famine today is stalking throughout the occupied countries of Europe. One wonders why, in an age when science has made man master over nature, there should be such a thing as hunger.

The hunger of primitive peoples was a different kind of hunger from that suffered by modern man. Primitive man was closer to nature. Hunger to him meant an aching, empty stomach. But since he lived closer to the soil, he more likely than not subsisted on plant and animal tissues and blood as he found them. In this way he got an abundance of minerals and vitamins and other essential nutrients.

Modern hunger, more often than not, is an artificially brought-about phenomenon. We speak of it as *hidden hunger.* Modern man, finding himself in an urbanized kind of civilization, depends on an almost endless chain of events and services before his food is finally eaten. It must first be grown. It must be taken from grower to processor. From the processor it must be sent to the distributor and from there to the retailer. Then it is still subject to handling and meal preparation. The ordinary person can, therefore, very easily be deprived of the minerals and vitamins and proteins which are necessary to make him healthy and strong. He can suffer from hidden hunger unless everyone handling his food—from the soil to the table—understands something about nutrition.

SCIENCE, FOOD, AND LIFE

The development of the various physical and biological sciences on which all modern knowledge of nutrition is based is relatively recent. It is less than 200 years since man discovered hydrogen, oxygen, and nitrogen, three basic elements in biochemical processes. It is only within this century that we have learned about vitamins

and how to isolate them and their great need in proper balance with minerals, proteins, and other factors in the human diet.

Progress in the field of nutrition came in somewhat the same manner as in sanitation. The general public first was skeptical of the germ theory. But people gradually began boiling their own water, watching their food supplies, and generally guarding against contamination. Finally, they recognized the need for public action in many sanitation measures such as sewers, water reservoirs, sanitary regulation of the milk supply, and the like.

It took time for people to appreciate the real importance of understanding the close relationship between diet and health. At first, researches were confined largely to animal nutrition. Results obtained with animals provided ample proof that human beings, too, might be benefited by applying science to eating. Despite natural variations in reactions among the different species, the response in man to nutrition is similar to that in numerous other mammals.

From the earliest researches in human nutrition, centering at first on elementary studies in proteins, carbohydrates, and fats, studies have now been undertaken which extend into the fields of hormones, enzymes, vitamins, rare minerals, and the many complicated biochemical processes in the human being. Research of this latter type is still in its infancy. But signs are already appearing which link nutrition with the phenomena of life, longevity, and the general physical, mental, and spiritual well-being of people.

The professional nutritionists like to think of Lavoisier as the father of nutrition.[1] He analyzed foods and found them to consist of three principal elements—protein, fat, and carbohydrates.[2] Liebig considered the first of these very important, and German chemists subsequently set out to determine the minimum amounts of protein required. Voit established 118 grams of protein a day as the standard requirement for a moderately active man. Atwater compiled the tables of the nutritive values of foods in common use in the United States, and the requirements for the various elements by individuals of different ages, sex, and occupations. Sherman pioneered in the requirements for minerals, and McCollum, Funk, and others in vitamins.

Some of the most significant developments in the field of nutrition during the past decade have been:

[1] Estelle E. Hawley and Grace Carden, *The Art and Science of Nutrition: A Textbook on Theory and Application of Nutrition* (St. Louis, 1941).

[2] J. C. Drummond and Anna Wilbraham, *The Englishman's Food* (London and Toronto, 1939).

lowered. Even under wartime conditions, the British government has taken steps to assure a minimum daily supply of milk to small children.

In this country, too, nutrition, as a matter of public policy, has found its way into government. As early as 1886 it was pointed out in a state document that obtaining a good diet is frequently not so much a matter of money as of winning people over from bad food habits to good food habits. Forty-eight years ago Congress appropriated $10,000 for the study of human nutrition in the United States.

More recently nutrition has entered as a policy matter into such developments as agricultural programs, consideration of nutrition in setting food standards, emphasis on nutrition education, and feeding programs among low-income groups.

The subject of food habits and the historical and social aspects of nutrition are ably presented by Dr. Richard Osborn Cummings.[1] Dr. Cummings goes into many factors, such as urbanization, technological change, and food habits brought to this country from many parts of the world, all of which have had a decided influence on American food standards of living. More studies of this type by sociologists, cultural anthropologists, social psychologists, and home economists will be of considerable help in bringing together facts rather than fancies about the importance of the various foods in the diet.

ADJUSTING PRODUCTION TO FOOD NEEDS

In the formulation of agricultural policy, the use of nutritional science to determine production requirements has gone well beyond the stage of theory. In 1933 a study called *Diets at Four Levels of Nutritive Content and Cost*[2] was begun by Dr. Hazel K. Stiebeling of the Bureau of Home Economics. This and subsequent studies, in which the Extension Service of the Department of Agriculture, the Division of Labor Statistics of the Department of Labor, and the Works Progress Administration cooperated with the Bureau of Home Economics, served as a basis for gauging the adequacy of diets of people of different income levels.

[1] Richard Osborn Cummings, *The American and His Food* (Chicago, 1940).

[2] Hazel K. Stiebeling and Medora Ward, *Diets at Four Levels of Nutritive Content and Cost* (U. S. Department of Agriculture, Circular 296, Washington, 1933). See also *Planning Diets by the New Yardstick of Good Nutrition* (U. S. Department of Agriculture, Bureau of Home Economics, Washington, 1941).

In 1935 this series of dietary patterns as they were found to exist in fact entered for the first time into the consideration of food-production planning. At the urging of Secretary Henry A. Wallace, and under the leadership of Dr. Howard R. Tolley and Dr. Stiebeling, steps were taken by the Program Planning Division of the Agricultural Adjustment Administration, the land-grant colleges, experiment stations, and state extension services to inaugurate a nationwide planning study to relate different systems of agriculture to the diets set forth in the Stiebeling findings. This series of studies showed that, if a satisfactory food standard was to be enjoyed by all classes of the population, it was essential to increase greatly dairy products, eggs, green and leafy vegetables, and crops ensuring the increase of these and other protective foods.

The Agricultural Adjustment and other farm programs were changed, as far as practicable, in such a way as to promote soil-conserving practices and at the same time increase those crops that would give the 130 million people of the United States the most satisfactory diet from the nutritional standpoint. Acreages previously growing some of the crops of which there was an oversupply were diverted to soil-conserving crops. County planning committees took an active part in recommending the adjustments for the counties and communities. Surpluses of basic crops were provided for in the Ever-normal Granary program, under which farmers received government loans for commodities stored under government seal. The policy of abundance was further strengthened by providing surplus outlet programs for such crops as fresh fruits and vegetables, dairy products, eggs, and other high-protein commodities. Among these were the stamp plan and the school-lunch program.

While this new trend of thought did not take into account the coming of war, it provided a policy background which is a fundamental factor in the setting of wartime and postwar food production goals.

DIETARY YARDSTICK AND FOOD PRODUCTION GOALS

In May, 1941, President Roosevelt called a National Nutrition Conference for Defense. It was presided over by Governor Paul V. McNutt, administrator of the Federal Security Agency, and coordinator of defense health and welfare services. The work of this conference was as important, from a standpoint of national policy making, as was that of President Theodore Roosevelt's Country Life Commission in outlining our national policy of conservation.

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One of the many outstanding contributions of the National Nutrition Conference was the announcement, by the Committee on Food and Nutrition, of the recommended dietary allowances for people of different ages. This standard provides a yardstick against which the nutritional quality of foods can be measured, meals can be balanced, menus for people of different incomes worked out. The intelligent use of this standard permits the serving of plain meals which nevertheless meet minimum nutritional needs.

Perhaps of greatest significance, however, is the fact that the recommendations of the National Research Council can play an important part in planning food-production goals. Some preliminary work of this nature has already been done by Dr. O. V. Wells of the Bureau of Agricultural Economics.[1] On the basis of three specified diets which meet the National Research Council requirements, Dr. Wells translated the nutritional needs of our estimated 1942 population into terms of crop acres and heads of animals required. Dr. Wells cautions the reader of the tables presented with his study that all figures are preliminary. He and other trained agriculturists know that statistical calculations of this kind are at best approximations and, therefore, subject to correction as subsequent facts and data come in. However, we have passed the pioneer stage of applying quantitative nutritional requirements to the establishment of agricultural food-production goals.

As this is written, in the midsummer of 1942, plans are under way for establishing the 1943 food-production goals. Conferences will be held between those responsible for ensuring the nation's food supplies. These include the President's Food Supply Committee, headed by Secretary of Agriculture Claude R. Wickard, Department of Agriculture officials, farmers and farm leaders, food administrators, college and experiment-station specialists, nutritionists, representatives of the food industries. Many factors will be taken into account. One of the most important will be the estimate of the kinds and amounts of food required to provide a minimum dietary standard for our population and to supplement the food required by the peoples of nations fighting on our side.[2]

NUTRITION, INDUSTRY, AND BUSINESS

Whether from the standpoint of improving food-processing methods, or from the standpoint of the welfare of industrial employ-

[1] O. V. Wells, *Statement Submitted to the Select Committee Investigating National Defense Migration*, House of Representatives, Feb. 13, 1942 (Washington, 1942, processed copy).

[2] This program has since been worked out.—EDITOR.

ees, industrial and business organizations must henceforth regard nutrition as an important social force which holds equal rank with health, sanitation, recreation, and the cultural, spiritual, and moral progress of the nation.

During a considerable part of the period of industrialization of food processing, the trend was actually in the direction of removing important nutritional parts of the raw food. Milling of white patent flour and sugar refining were typical examples. This was not the fault of processors or manufacturers. They merely tried to accommodate public demand. Mankind as a whole was simply ignorant of the tremendous implications of nutritional quality, of eating a properly balanced diet, and of the bad effect of numerous preserving and transporting methods on health.

Food-handling and -processing developments were largely the result of American genius for short cuts to manufacturing methods, of a high degree of promotional ability on the part of American businessmen, and of a general desire for the convenience, ease, and comfort enjoyed by Americans before the outbreak of the Second World War. Nutritionally, many of the early food-processing methods fell short of making a contribution. One can only speculate as to what the effect on the health of the present generation might have been if the nutritional knowledge of today had been available to the early pioneers in industrial food manufacture.

Even today, it still remains quite a question as to whether or not people are going to pay a great deal of attention to nutritional quality in food. To make the general public nutrition-conscious is one of the main purposes of the National Nutrition Program. In this the government has been aided by a large segment of the commercial food industry. Many important food industries are now emphasizing the nutritional quality of their product in the advertising and merchandising of their product. They are, by and large, doing so with a sincere desire to arouse interest in good nutrition generally, rather than indulging in exaggerated breast thumping regarding the nutritional advantages of their own respective products.

In a few foods, like bread and oleomargarine, enrichment or fortification with vitamins under principles recommended by the National Research Council and standards approved by the Food and Drug Administration have been regarded as good public policy. In a few states, the enrichment principle has been made mandatory by law. To date, however, this has been applied to only a few foods. Naturally, it is in the public interest that such enrichment

of foods should meet the most rigorous tests, both in the laboratory and in the determinations of impartial bodies of science; that sound determinations, based on scientific finding, are made by those responsible for setting the regulations regarding food standards; and that such enrichment does not result in unfair trade practices that place producers of a naturally more nutritious product at a disadvantage.

NUTRITION AND THE POSTWAR WORLD

The present war is unquestionably going to produce much new experimentation in the field of nutrition. This is true particularly in the direction of techniques in the handling of foods. No one claims to have complete knowledge in this field yet. But we are at a point where revolutionary changes in the handling of food are taking place. Without doubt, consideration of nutritional quality will have a great deal to do with the handling of food in the future.

We are in a sky-minded age. Already air transport of foods is becoming an important factor in supplying food to troops in isolated places and to populations in need of food. The preparation and shipment of food in this way may become a permanent thing after the war and offers many possibilities to carry such important foods as dried milk and eggs, dehydrated fruits, vegetables, and meats, to out-of-the-way places like the tropics.

Developments regarding food which come from the experimental efforts of the present war emergency are likely to leave lasting changes. No doubt food in the postwar world is going to be regarded in its health sense, and governments will have a deliberate policy to ensure that everybody has the right diet.

Nutrition will also play a leading, if not a dominant role, in the shaping of international relations after the full fury of the present devastating global war has subsided. There is a school of leaders in both Great Britain and the United States who look forward to a peace and a civilization based on human needs. Progress in the field of nutritional research, and development of methods whereby we can gauge approximate dietary needs under a reasonable food standard, offer a starting point from which any nation can calculate its minimum food requirements. When this is coupled with intelligent planning of agricultural production on a worldwide scale, and with good will and intent as between nations, there is no doubt that people of all the earth will have the opportunity to enjoy improved health and a happier allround existence.

CHAPTER XVII

AGRICULTURAL PROBLEMS[1]

JOHN D. BLACK

The nature of the problems that will confront agriculture in the United States at the end of the war is very highly conjectural, but possibly no more so than that of the problems of the general economy. The dislocations which accompany inflation and subsequent deflation have always been unusually serious in the case of agriculture. If prices are permitted to rise considerably during the war and in the secondary inflation period that follows, there will be a strong demand for the support of prices of farm products. The political situation is likely to be such that this demand will be met in large measure, particularly if urban wage rates hold up as they did after the First World War. This will create a condition of maladjustment for the general economy unless prices can be sustained across the general front. In the past, the low annual earnings of urban workers resulting from vast unemployment in spite of nominally sustained wage levels have been offset in part by cheap food and clothing. This may not prove to be true this time if a postwar depression of the general type of 1921–1922 develops, following a brief period of postwar prosperity.

Any such inflation as has just been hypothecated would be accompanied by a writing-up of farm real estate values and considerable buying of land under heavy mortgages at these inflated values. Land values rose substantially in 1941, after remaining practically level from 1937 to 1940. They are still climbing.[2] During the period from 1920 to 1929 values of farm real estate declined at a decelerating rate.[3] They took a further slide in 1930–

[1] This analysis is a by-product of a research project on agricultural policy financed by the Committee on Research in the Social Sciences of Harvard University.

[2] J. D. Black, *Parity, Parity, Parity* (Cambridge, Mass., 1942), pp. 48, 240–248.

[3] During the same period, prices received by farmers were at levels very close to the "all commodity" wholesale price level during the decade.

1933. Taking the whole period from 1920 to 1940, nothing contributed more to the adversities under which agriculture suffered than this deflation of farm real estate values. In many sections of the country, every third or fourth farm went through some form of forced sale during these two decades, and some of them more than two or three times.

The method now likely to be most favored for supporting prices of farm products will be the device of "loans without recourse," which has come increasingly to the fore since 1933. These are loans on storable commodities held by farmers, which they can redeem or not as they see fit. They may see fit if the price keeps above the loan value and they need the additional income, or if they think the moment a good one at which to sell. If the price has dropped below the loan value, they let the government worry. The government in such case is likely to extend the loan, hoping for higher prices in another year. This procedure effectively holds the supply off the market and keeps it from depressing the price. Thus, in general, the government tends to accumulate stocks from year to year, since buying and holding commodities is easier than disposing of accumulated stocks.

Confronted by an offer of such a loan, the producer of cotton, wheat, or corn considers whether the loan offer is higher than the market price is likely to be. If he thinks the loan offer is higher, he is pretty sure to accept it and to put his crop in storage, counting upon "selling it to the government." If he thinks otherwise, he may accept the loan anyway, taking advantage of the government's offer to help him carry his crop until he wants to sell it or feed it.[1]

To make a program of loans without recourse work successfully even over as short a period as 2 or 3 years, some procedure must be devised for disposing of the stocks which the government accumulates "outside the normal channels of trade" or some procedure that will reduce the volume of oncoming supplies. Probably in practice both are needed. Accordingly, assuming for the moment a period of postwar deflation, the United States will be faced by a demand for resuming the kind of production controls that were introduced in 1933, which we still have with us so far as wheat, cotton, and tobacco are concerned, but which may largely disappear if the war lasts 3 or 4 years.

Even though there is no period of acute deflation, our agriculture in the United States will be faced with the need for some important

[1] Black, *op. cit.*, Chap. XX.

shifts to a peacetime basis. The nature of these shifts, however, is greatly dependent on the outcome of the war. If the accustomed sources of supply of tropical oils in the East Indies and Africa are cut off, we shall want to continue and even expand our production of soybean, peanut, and other vegetable oils, Likewise, if rubber from Malaya and the East Indies is no longer available, we may want to continue growing grain as a raw material for industrial alcohol. Even though the war ends in 1944, as seems to be the basis upon which planning is now being done, there will be much urging that we continue domestic production of these products so as to be no longer dependent on the outside world for them in case of another war. There will be equally strong support, however, for the opposite policy of resuming trade with the countries in order that they may be reestablished on a basis that will maintain peace in the world. Around this issue will center some of the important debates of the postwar years.

The United States will also have a considerably expanded output of dairy, poultry, and pork products, judged by prewar standards. Will it be possible to sustain this volume of production, or will adjustment back toward prewar production organization be necessary?

It is entirely possible, of course, that all the increased output of foods and fibers will be needed to take care of the postwar consumption of these products at home and in those countries which we may be helping to reconstruct. The outcome of the war and the international arrangements for the armistice period may be such that every ton of food that this country and the allied exporting countries of the New World can turn out will be needed to feed the hungry populations of the lands devasted by the war and to continue the levels of feeding that have been developed in the United States, Great Britain, and elsewhere as a contribution to the vigor of the war effort. On the other hand, the war may so end that this country will find itself faced with the necessity of disposing of most of its agricultural production at home, at least for several years.

NUTRITION AND FOOD SUPPLY

Let us assume for the moment, however, an outcome of the war such that the provision of food for undernourished people generally in all the United Nations becomes a feasible objective. What are the possibilities along these lines, and what do they mean for

agriculture in the United States? In order to understand the nature of the difficulties inherent in such a program, something must be said about the nutritional conditions under which most of these people are existing.

Charles Morrow Wilson, writing recently in *Harper's Magazine*, has opined that one-half of the population of the Latin Americas are ill. This guess is safe enough—but a still safer one would be that two-thirds of it is inadequately nourished. We know the second is the major cause of the former. No person improperly fed year after year can remain well. If there are 65 millions of poorly fed people in the Latin Americas, there are twice or thrice this number in Europe, and ten times as many in Asia and the East Indies. Here at home, the common report is that a third of our people are poorly fed, and another third only fairly well fed.

These fractions mean little as such. A definite line cannot be drawn around malnutrition. Harvard University's great authority on nutrition, Dr. George R. Minot, draws a block diagram, and across the top of it a line marking off about 15 per cent of the ordinary run of people in this country who are truly well nourished. Across the bottom, he draws another line marking off another 15 per cent or so who have definite clinical symptoms of poor diets. In between comes the great bulk of the population living "suboptimally" most of the time and yet managing to escape positive disability; some of them keep well toward the top, but others show clear symptoms of malnutrition now and then. During an attack of fever or even of a cold, one's system does not receive the usual amount of important vitamins from food, and, without these, nutrition suddenly drops to clinical levels. The same thing happens if one is exposed to unusual strain or fatigue, as soldiers are in a campaign.

Thus, even in our own country, only a small fraction are in vigorous buoyant health all the time. The majority of Americans lack the diet that is indispensable to energy and robust health.

But if Dr. Minot were drawing his chart to represent some of the Latin Americans, say our own Puerto-Ricans, his clinical line would rise to take in half or more of the diagram. One could proceed to enumerate the specific dietary diseases that are prevalent in such situations. It is enough merely to say that people living on this subsistence level grow old and haggard before they are fifty, and the average expectancy of life may be under forty years. The incidence of disease and disqualifying defects in our Selective Service experi-

ence has been found to be 36 per cent at thirty-six years of age, contrasted with only 13 per cent at twenty-one years.

But malnutrition wreaks greatest havoc among the children. Infant mortality rates may run into the hundreds. Two states in our own country—New Mexico and Arizona—have rates of over 100. There have been scientists of a sort who have insisted that these high infant mortality rates are not an evil, that they kill off the weaklings so that only the sturdy survive, and that the race stock is thereby made virile and resistant. The empirical evidence all points another way, to a general weakening in childhood of a large proportion of those who do survive the first blasts—with a high mortality rate at an early age for the survivors.

Some comment should be made on measures of material well-being appropriate to a consideration of a program of the sort under discussion. It must be kept in mind that figures on resources per capita are only averages, and that population pressure is always on the margin, *i.e.*, among the lowest income groups in any country. Probably there is very little difference between the living conditions of the poorest group in the different countries. Locate them in any section of the world and they will be found to be living on a bare subsistence level, not even enough to allow them to reproduce their numbers. More die than are born. Then there is a larger marginal group in which net reproduction is a slightly positive quantity. But the existence of such groups as these two in almost any country is not the question at issue; we know that they exist in all countries. The important point is the proportion of them, relative to the total population. The fraction is large—perhaps over a half—in much of the Orient, in Puerto Rico, and among many of the Indian groups in the Latin Americas. We have a small fraction of them almost anywhere in the United States, a fairly sizable one in a few spots.

Among the non-Indian population of the New World countries, and in much of western Europe, the largest marginal group consists of the families that have been able to raise their plane of living somewhat above the mere subsistence level, to include a few comforts, a modicum of medical care, a little education for the children, an occasional night at a cheap movie house, and the like. This group probably makes up two-thirds or more of the population of Great Britain and of some of the peoples of western Europe, and one-third, at least, of the people in the United States.

Obviously, to throw these three marginal groups into one national average, which also includes perhaps another 10 per cent who earn

half the national income, does not give us any meaningful or useful measure. Our concern is mainly with these marginal groups per se. How well do these groups feed themselves, for example?

Two important circumstances that have an instructive bearing on the matter of the diets of these marginal groups must be presented. The first is that a large fraction of them work for cash wages as laborers on highly commercialized plantations and eat very little except cheap staple foods, which they buy with their wages. A clear example of this is provided by the natives who work on the Dutch sugar plantations and eat rice imported from the mainland. The sugar-plantation laborers of Cuba, Puerto Rico, and Hawaii are in the same bracket, as are the rubber-plantation workers, the cacao workers of Ecuador, the coffee workers of Brazil, the sisal workers of Yucatán, etc. These groups ordinarily have no land of their own and produce nothing for their own consumption. Cash-crop cotton production in the United States is pretty much of the same pattern. Although the cotton workers operate the land as croppers or tenants, they have tended in the past to put most of their tillable land into one cash crop. One can find the counterpart of our cotton production on grain farms in eastern Europe. The second circumstance is that the staple foods which these workers consume have become more and more refined. The rice is polished, the cornmeal has its germ removed, and the bread is made more and more from white flour.

Relatively few if any of the three marginal groups above listed are fed at or even near the optimal line. Most of them are somewhere in the lower half of Dr. Minot's diagram. The landless workers on large plantations are merely one important type of these underfed marginal people.

What has the United States to offer as its contribution to a program for better nutrition for these groups at home and abroad? Surely no phase of postwar planning is more vitally significant or offers more real promise for peace at home and in the world at large. The utopias that are being designed by the various schools of after-the-war planners have many delightful chambers in them. Mr. Roosevelt has limited his to four—the "four freedoms." Some others have not been so easily satisfied. The writer will be content if out of this new world war will come just one new generally accepted idea or principle, *viz.*, that each child and each worker shall be assured the opportunity of a minimum adequate diet,

and that means shall be taken to establish food habits that will comprise such diets.

Merely abolishing hunger or partial starvation will go a good way toward checking the unrest among the great masses in the marginal groups and making good democratic citizens out of untold millions of people who now doubt their governments. If, in addition, these people can be supplied with the protective foods needed to furnish them with a sound basis for health and vigor, a large part of the discontent that is rife among bodies politic will disappear.

The International Labour Office has published its conclusions from a study made of Great Britain's wartime food program. This report says:

> There seems little doubt that the milk scheme will remain as a permanent part of British social policy, and already many are urging that its scope be extended. The extension of communal meals, especially in the schools, in the factories, and in the mines, has provided for decent mid-day meals facilities that will not be scrapped when the war is over.[1]

This system of providing one good meal of the proper supplementary protective foods to workers in factories and in mines is just beginning to take hold in the United States. It should be encouraged with great energy. Such meals can be assumed to be a necessary part of wages and required as a wartime measure in this country as in England. When the war is ended, they will then be accepted as an essential feature of the "working conditions" over which employer-employee battles are constantly being fought. The employers will have discovered by then that the increased output of their workers and the saving in costs from illness and absenteeism far outweigh the cost of the meals. Free school lunches, prepared so as to make up deficiencies in the home feeding, can be accepted as a regular and expected part of educational programs, as essential as textbooks.

These two programs alone will not reach all who need help with their diets, especially those peoples whose social institutions are not so far advanced as our own, but they will go a long way toward it. The children will carry into their homes the habits and lessons learned from the school lunches; in lesser degree, so will the adult

[1] *Food Control in Great Britain*, prepared in Montreal and London by Edith Tilton Denhardt of the Economics and Statistical Section of the International Labour Office.

workers in factories. The further measures needed will follow easily in due time.

Several eloquent passages about foods and nutrition have of late been included in addresses dealing with the international phases of the postwar period. The hungry are to be fed in the countries released from the dictators, and, after that, the diets of the multitudes in the crowded regions of Europe and Asia are to be supplemented with the needed protective foods.

Between what we are doing now in this country, what the British Empire is doing, and Russia, and China (the democratic quartet), what the political leaders in this country are thinking—in the United States, the writer has in mind particularly the Farm Bloc—and these idealized programs of international food dispensation, there is a vast gap. It is easy to idealize the future. Any of us can design a utopia. The difficult problems are those of getting our government and our people to take the necessary steps in the direction of the desired goals, to take them one at a time from month to month and year to year.

Out of the various forms of communal feeding which will follow the war in Europe and elsewhere, let us hope that something in the nature of permanent food and nutrition programs can be salvaged. One prospect by way of a transition from emergency to permanent programs is that of using the schools as agencies for providing children with protective foods. Using the factories and workshops in similar manner may be another.[1]

SURPLUS DISPOSAL

The more that is said about solving the problems of international food distribution and minimum adequate diets for all, through leveling of tariff barriers, the less the chances are that the Congress of the United States will permit the necessary steps. Every doctrinaire internationalist who starts talking along these lines endangers the program of nutrition improvement.

The proposal for an international Reconstruction Finance Corporation has similar dangers. The language of billions which the RFC customarily uses is frightening to those many millions of our people who are appalled by the prospect of a national debt of $300 billion.

A safe transition can be made, however, by an intelligent and forthright application of the new principles of international arrange-

[1] Dr. Wilson has further discussed the problem of nutrition.—EDITOR.

ments that have developed out of the present conflict. Along the path from lend-lease for winning the war, to lend-lease for feeding the starving people of released Europe, to lend-lease for reconstruction, and finally to lend-lease for keeping the peace of Europe and Asia lies the safest approach to the desired goals. Moreover, the international financing of it can all be arranged in such a way that it contributes strongly to continuing prosperity in our own land.

If no such program of international utilization of agricultural products proves possible, then, as stated earlier, each of the countries with expanded wartime production will need to develop plans for disposal of surpluses at home, at least until such time as production can be restored to a peacetime basis. The most obvious form which such disposal can take is the selling, out of accumulated granaries, the stocks that have been acquired through the medium of loans without recourse. In this country the Farm Bloc is opposing such procedures at present because it wants to see farm prices reflect in full measure the influence of the war situation. Once the war is past, however, no realistically minded person can look forward to the holding of these stocks indefinitely. One can expect, therefore, that even the Farm Bloc will approve measures relating to disposal of accumulated stocks outside the normal channels of trade. In a few cases this may mean the utilization of them in lower value uses, such as potatoes for starch, or cotton for road building. Commonly, however, the best channel will be among the low-income people of this country through such programs as school lunches, direct distribution, and the orange and blue stamp arrangement.[1]

THE PRODUCTION PROGRAM

No one of these programs will meet the needs of the occasion, neither will all of them put together in their present form. Instead, a comprehensive integrated program of consumption adjustment will be needed, which will reach all groups in the population that are improperly nourished. This is no occasion for demonstrating that an adequate food intake of the population of the United States would require a larger output than in any year of the nation's history, including the bumper crop of 1941, which was 14 per cent above the 1935–1939 average, and the 1942 crop, which was substantially larger than the 1941 crop. Nevertheless, the data all bear out such a conclusion.

[1] Black, *op. cit.*, Chap. XXI.

If a well-integrated program of consumption adjustment were developed, the nation would find itself needing to adapt its production program to its consumption needs. Expansion would be the keynote. The output of farm products which we would need in greater quantities would be so great that the pressure would be toward *increasing* the production of those goods rather than toward *restricting* the output of those products which in the past we have tended to produce in too great amount.

A particular reason for this is that the improved diets would call for an expansion of output of dairy and meat products, and this expansion would call for the use of more acres of land. This country would have then much more of its land in pasture and forage crops, but it would need to increase the yields of the land devoted to cereals in order to obtain the concentrates needed to supplement the forage rations.

A rise of extensive cultivation of this sort would improve greatly the fertility of the soil and would contribute in a large way to the conservation program that we had started before the war. This evolution would be particularly important in much of the South, which very greatly needs to shift toward general farming, with forage and cereals and livestock as the main lines and cotton and tobacco as supplementary cash crops.

POPULATION ADJUSTMENTS

If, however, such a change to extensive cultivation is going to prevail in the South, its population of agricultural workers must be reduced considerably below present levels, probably even below the levels that may result from the further expansion of war output that can be expected if the war lasts several more years. The critical factor in the situation will be the keeping of these workers from returning to the overcrowded rural areas, first, in the conversion period just at the end of the war, second, in the first real depression period afterward, and, finally, in a possible very severe depression that may come still later, paralleling that of 1930–1933. It has become apparent that preventing such depressions is as vitally important from the standpoint of maintaining a proper ratio of population to resources in areas now congested, as from the standpoint of the baleful effects of the accompanying slump in agricultural prices. In the decade of the twenties, the cityward movement of surplus farm population was accelerated appreciably by the higher real wages that had come to prevail in the cities and by the expan-

sion of employment, particularly in distributive industries, which accompanied the revolution in transportation that came with the automobile and truck. In the early thirties, this migration was checked and there was even a small net movement the other way for 1 or 2 years. Analysis of this movement has shown that the families thrown out of work in the cities tended to return to the same low-income areas from which they had migrated.

RURAL PUBLIC WORKS

Programs of public works to take up the slack of employment in the conversion period immediately at the end of the war, and in subsequent depression periods, should not, however, overlook the needs of rural areas. Thus far the public housing programs of the United States have been almost wholly confined to cities. One has to go almost to the worst slums of our large cities to find as wretched housing as prevails in the rural sections in the South and Southwest. The needs for public sanitation and recreation developments are equally important. Programs of this sort, however, need to be formulated with reference to the total picture in any given area and to be developed in such a way that they will not return large numbers of war workers to their former haunts.

Much thinking about rural public works is also running in terms of resuming the program of soil conservation which is now being retarded because of concentration on the war effort. As the nation approaches the end of the war, it will need to review in a comprehensive way its experience with soil-conservation measures and to develop an integrated, effective program for attaining the goals that are then set. It may well prove to be the case that some of the practices worked out and applied in the last 10 years have not stood the test of wartime production.

The program of flood control and watershed development formulated in this country since 1933 is now much more subordinated to the war effort than the direct soil-conservation procedures. A large amount of basic planning has been done, and it should be easy to lay out feasible flood-control projects whenever resources can be spared for them during depressions.

The war demands for lumber have been appallingly large. Because of transportation shortages, the timber stands that are nearest to the place where needed have tended to be stripped. As a result, timber that might have found a market gradually over the next 30 years has been harvested all over the East and South. The

nation will therefore need to undertake a more vigorous program of forest management and reforestation than was in prospect before the war. Much of this will be on farm woodlands and can be combined with farming operations if suitable systems of credit can be devised.

LAND-USE PLANNING

Basic to any sound program of rural works is a large amount of sound land-use planning. Grants and loans should not be made for construction of farmhouses except on the basis of planning that will indicate which farms are likely to persist under the conditions of competition likely to prevail in the postwar world. Even housing repairs need to be based on such plans. There may be warrant for improvements in areas where agriculture is likely to be reorganized on a more extensive basis, but each situation of this sort needs to be thoroughly explored. Similarly, the various conservation and forest restoration measures need to be fitted into carefully developed land-use plans.

Fortunately, such plans have already been formulated in a few dozen counties under the county land-use planning program that has been fostered by the Bureau of Agricultural Economics jointly with the agricultural extension services of the various states. In a much larger number of counties, planning organizations have been set up and considerable progress has been made. Perhaps more important than the actual progress is the education in such planning, which has accompanied the planning effort in the last 5 years. During the war, most of the kind of planning that is needed for the postwar period has been set aside. Planning committees and the agricultural extension services have been assisting the County War Boards with activities directed toward getting out the enlarged agricultural production demanded for our own war effort and for lend-lease shipment. What type of organization and Federal-state collaboration will be best suited to the needs of postwar land use planning is difficult to indicate at this time. At the proper time in the course of the war, when the end of it begins to be sighted, this question should be taken up and carefully reviewed.

Any agency which undertook at this time to make land-use plans for the postwar years might very well find its recommendations largely ignored when the time came. There are too many uncertainties in the picture, and any assumptions that might now be made with respect to these points would in all probability be wrong. The optimum use and type of development which any tract of land

should receive is highly conditioned by the market at the end of the war for different types of farm and woodland products. How much of an outlet there will be for the products of this country in the rehabilitation efforts abroad, and how much of a program for improving the consumption of our own populations, will determine in an important way how much of the land should be in pasture, forage crops, grains, and woodland. The agriculture of a region such as the Northeast is greatly dependent upon how much of a market is provided for milk among the low-income families of the cities. The combination of grazing and cereal production of the Great Plains is likewise dependent upon the prospects of outlets for beef, wool, and wheat.

Equally important for any postwar land use planning will be the program that the nation undertakes for converting its war industries and for maintaining full urban employment at the end of the war, and, likewise, the success which is achieved in carrying out such a program. With one outcome, a strong movement toward extensification of agriculture, larger acreages per farm, and more use of power machinery will arise. With the opposite outcome, the trends in this direction will be retarded.

TENURE

Specific comment needs to be made on the role of machinery in postwar agricultural developments. Regardless of the programs for postwar employment that are adopted, we are likely to witness a strong urge toward the use of machinery and power on farms in all parts of this country. The limited allocations for the manufacture of farm machinery during the war years—the expected allocation for 1943 is 30 per cent of 1941 sales—is going to produce a very great need for such equipment. The heavy burden of labor which has been imposed upon farm people in getting out the war production will contribute to the same reaction. Generally speaking, the farmers of the country will have been receiving much larger incomes during the war and will either have reduced their outstanding debt to a point where they can purchase machinery, or they will have war bonds and other savings accumulated. Perhaps most important of all, the nation will have a tremendous capacity for machinery production, and out of the experiences of the war will come some revolutionary ideas for improving farm machinery. It therefore seems a safe forecast that a very great change toward the use of more

power and machinery will take place at the end of the war, regardless of almost anything that can happen.

Many in this country look forward to such a prospect with grave forebodings. It predicts for them the rise of great factory farms and the passing of the family farm. This need not happen if the situation is properly handled, and, as a matter of fact, will not happen in any overwhelming way even if nothing is done about it. The manufacturers of farm machinery have an interest particularly in producing machines that can be used on family-size farms. They have a much larger and better market with farming organized on this basis than otherwise. However, the matter should not be left to the self-interest of the manufacturers. There is a public interest in the family-size farm, which warrants adopting measures that will ensure its overwhelming prevalence in nearly all parts of the country. These measures may include credit for the manufacture and purchase of machines, the expansion of the tenant-purchase program with its strong emphasis on family-size holdings, and vigorous extension programs designed to develop successful systems of management for family-size farms. The way to ensure perpetuation of family-size farms is to see that they have land enough and equipment enough to ensure a decent reward for the operators and a scale of living that will make it possible for the sons and daughters to obtain a good education.

Chapter XVIII

INTERNATIONAL COMMODITY AGREEMENTS IN THE POSTWAR WORLD[1]

Joseph S. Davis

In the midst of the grim tasks of waging the most titanic world struggle in history, our supreme objective is victory over the forces that threaten brutal subjection of all free peoples. Yet the peace must be won, as well as the war. Constructive steps toward establishing a more progressive world order on more solid foundations must be taken while the war is on and can be potent auxiliary weapons of war itself. Accordingly, thousands are already earnestly wrestling with postwar problems, in official, semiofficial, and unofficial capacities. Such efforts, hopelessly inadequate to date, are promisingly cumulative, and much further progress in these directions is vital to the success of the United Nations.

Humbly, unofficially, and in preliminary fashion, I venture to explore a small sector of the field of postwar policy that is now in the making, one phase of international planning in the concrete. Penetrative thinking, realistic analysis, and frank expression are called for, to puncture bubbles of illusion and dispel dreams that obscure genuine vision, as well as to pave the way for solutions of the vexing problems involved. Here the attempt is to clarify issues rather than to settle them. Specific, comprehensive advice must wait on maturer understanding than anyone yet has. Prophecy too is beyond my competence, but at the outset one needs to state the reasoned assumptions on which his discussion rests.

PERTINENT ASSUMPTIONS

First, I assume that there will be a postwar world; that this war will truly end, sooner or later; and that, contrary to the prophets

[1] This study is essentially a revision of a paper presented before the American Economic Association in December, 1941, and published in the *American Economic Review*, Vol. XXXII (Papers and Proceedings, March, 1942), pp. 391–403.

of doom, Western civilization is tough enough to survive both current and postwar crises.

No one can safely predict the length or outcome of this far-flung war. Who wins, and when, and how, will profoundly affect the nature of the postwar world and the role of international commodity agreements in it. Accordingly, it might seem appropriate to consider elements and issues of policy in relation to alternative postwar worlds, notably two: (1) a world dominated by Nazi Germany, or by some combination of Nazis and Japanese; and (2) a world freed from such domination, actual or threatened. A possible intermediate type I deliberately exclude, primarily because I assume that this war will not really be over until the Axis powers definitely lose or win. If a so-called *peace* is negotiated before that central issue is decided, war economies will merely be modified and not replaced by true peace economies. In that event, international commodity agreements might be utilized as weapons of economic warfare, even more than now; but it would not be in a truly postwar world.

There is no point now, however, in discussing international commodity agreements in an Axis-dominated world. The term *agreement*, indeed, is inappropriate for arrangements made in Germany or Japan, dictated by their experts, and imposed on other political units. Moreover, an Axis victory is neither imminent nor inevitable, despite vast gains by Germany and Japan since November, 1941. For the present, I am unwilling to expend energy reasoning on the assumption that the war may be lost by what we at last unitedly recognize as our side.

Assuming, then, the eventual defeat of the Axis powers, I make the further assumptions that a postwar world with some kind of political and economic freedom can emerge from the storms and strains of war and oppression; that the postwar world will still be made up of more or less independent nations, however they may be tied together; that the British Empire and the United States will play the most influential roles in shaping and guiding that world, with Soviet Russia and China exerting powerful influence also; but that none of these, nor all four together, will dominate it as Nazi Germany and Japan would if they should win.

Further, I make bold to assume that the United States will bear its full share in constructive world leadership. This implies that we have outgrown isolationism. During the past 2 years we have become increasingly conscious of the vital role the United States has to play in this terrific struggle, and the view is gaining that any sort

of assurance against its recurrence requires that we help safeguard the peace that follows victory. Progress of American public opinion encourages the belief that we shall be ready to play a sounder role after hostilities end than we did in 1919. Vast expansion of our navy, air force, and war industries, and experience in integrating them with those of the British Empire and its formal allies, should render easier practical measures of postwar cooperation in guarding the peace of the world. Current and prospective strides in aviation increase the feasibility of political, economic, and military collaboration. While major issues remain to be faced and decided, it no longer seems simply idealistic to look forward to the United States taking its due share in world leadership after the war.

My next assumption is even bolder: that ways will be found to dispel fears of another world war, for a generation or so. Otherwise, we must expect every nation to strive, even more vigorously than in the recent interwar period, to become as self-sufficient as possible in what are regarded as basic foodstuffs and basic raw materials, even at grave sacrifice of otherwise attainable consumption levels.

I also assume that international agreements, of various kinds, will have a large place in such a postwar world. The alternatives are wholly independent actions by the several nations, taken with conflicting views of national interests, or outright domination exercised by one or more within particular spheres of influence. Some of both there will doubtless be, but I assume that successful efforts will be made to enlarge the subject areas covered by general and specific agreements.

Finally, I assume that some such agreements will be made with respect to individual commodities. Prewar and wartime experience, pressure of postwar needs, and evolution of thought in high circles, all seem to point in this direction. Blundering there will be, of course; but the better the advance thinking, the smaller the area of blundering is likely to be.

These are assumptions, not predictions. They seem to me reasonable, though rather optimistic than pessimistic. But even on such assumptions, many questions remain: What commodities will be involved? What objectives will be sought? What types of agreements will be tried? What principles will be followed?

THE POSTWAR TRANSITION PERIOD

One important distinction must first be sharply drawn. Real peace does not instantly follow war. As time is required to convert

a peace economy into a war economy, so it takes time to reconvert a war economy into a peace economy. Armistice Day, 1918, conveniently marks the end of the First World War, but a transition period lasted well beyond the signing of the Versailles Treaty, perhaps into 1925. Extensive reconstruction will be necessary, and many special problems will press for solution, in the transition period following the Second World War. We cannot now forecast its timing and length, but we may safely expect some years to elapse before peace becomes full-fledged. What role may international commodity agreements have in the postwar transition period?

When hostilities cease, grave shortages of foodstuffs and raw materials in many areas will presumably coexist with huge surpluses of such commodities elsewhere, as they have during most of the war to date. Cessation of war requirements, including needs for special war reserves, will release for peaceful uses stocks of many goods. The urgent tasks will include human relief and rehabilitation on a gigantic scale, in addition to rising international trade in the usual sense. The problems will be to match needs and supplies, to organize and finance this special movement of goods, and to provide for physical shipment and ultimate distribution with the utmost speed, efficiency, and equity. This will assist in guarding against civil turmoil, revolution, and early recurrence of hostilities. Even the strongest countries will have an interest in seeing that the distress incident to the war be quickly relieved instead of allowed to grow worse, that the means of economic recovery and rehabilitation be made promptly available, and that surplus stocks be used instead of lying idle, deteriorating, or being destroyed. Well in advance, the basis and terms on which international gifts and loans are made will need to be wisely conceived and clearly set forth.

One basic point will not be overlooked in planning and execution. While the United States will presumably furnish a substantial share of both commodities and financial resources, the enterprise will be a joint one, including not only the United Nations and their dependencies but various countries that are still nonbelligerents. Even the food commodities involved may include corn, beef, coffee, sugar, and Latin American and African fruits as well as wheat, cotton, wool, lamb, pork, dairy and poultry products, and fruits of North American and Australasian origin.

Mr. Churchill said in the House of Commons on Aug. 20, 1940:

> We shall do our best to encourage the building up of reserves of food all over the world, so that there will always be held up before the eyes of the

peoples of Europe, including—I say deliberately—the German and Austrian peoples, the certainty that the shattering of the Nazi power will bring to them all immediate food, freedom, and peace.[1]

In the following year the British government made considerable progress on plans to this end.[2] During the summer of 1941, the United States Secretary of Agriculture expressed our government's adherence to much the same policy, coining the catchy if misleading slogan "Food will win the war and write the peace."

It was "to organize in good time the action required to give effect to this policy" that the British government sent invitations to a historic interallied conference held in London on Sept. 24, 1941.[3] Here the Roosevelt-Churchill Atlantic declaration was endorsed by official representatives of the USSR and eight conquered countries. as well as by representatives of the leader of Free Frenchmen.[4] More specifically, this conference adopted a six-point declaration calling for their organized collaboration in drawing up, and eventually executing, detailed programs for promptly supplying the liberated peoples with "articles of prime necessity" after the war.[5]

[1] Winston S. Churchill, *Blood, Sweat, and Tears* (New York, 1941), p. 344.

[2] Summarized by Anthony Eden at the interallied conference mentioned below: *Inter-allied Review* (Inter-allied Information Centre, New York), Oct. 15, 1941, p. 7.

[3] *Inter-allied Review*, Oct. 15, 1941, p. 7.

[4] *Ibid.*, p. 1.

[5] This declaration reads:

"1. That it is their common aim to secure that supplies of food, raw materials, and articles of prime necessity should be made available for the post-war needs of the countries liberated from Nazi oppression.

"2. That while each of the Allied Governments and authorities will be primarily responsible for making provision for the economic needs of its own peoples, their respective plans should be co-ordinated, in a spirit of inter-allied collaboration, for the successful achievement of the common aim.

"3. That they welcome the preparatory measures which have already been undertaken for this purpose and express their readiness to collaborate to the fullest extent of their power in pursuing the action required.

"4. That accordingly, each of the Allied Governments and authorities should prepare estimates of the kinds and amounts of foodstuffs, raw materials, and articles of prime necessity required and indicate the order or priority in which it would desire supplies to be delivered.

"5. That the reprovisioning of Europe will require the most efficient employment after the war of the shipping resources controlled by each Government and of allied resources as a whole, as well as of those belonging to other European countries, and that plans to this end should be worked out as soon as possible

Auspiciously, the lead in evolving this ambitious joint program was entrusted to Sir Frederick Leith-Ross, the able and experienced chief economic adviser to the British government. Despite war pressures, progress is undoubtedly being made, though as yet few details have been disclosed to the public.

Foreign Secretary Eden told the interallied conference: "In this, as in so much else, we may confidently hope that the great nation across the Atlantic, as well as other friendly nations, will in due course lend their cooperation."[1] In an admirable address before the National Foreign Trade Convention on Oct. 7, 1941,[2] Undersecretary of State Sumner Welles gave assurance of American support for such a program. While not mentioning the conference, he spoke of the same objectives, adding: "Both humanitarian considerations and self-interest require that we cooperate to these ends to the fullest extent of our ability. So long as any important part of the world is economically sick, we cannot be well."

Since Pearl Harbor, with the United States a fighting partner and a new leader among the now United Nations, British-American mutual understandings and joint agencies have been expanding, and cooperation is becoming a fact of widening scope. The "master" Mutual-aid Agreement between the United States and the United Kingdom signed on Feb. 23, 1942,[3] and like agreements with other beneficiaries of lend-lease aid, set forth certain basic, agreed principles of great importance for postwar policy. A series of notable addresses by American, British, and other statesmen are helping to supplement formal commitments by improved public understanding—as yet short of legislative approval.

On the basis of such over-all agreements, flexible yet fairly specific relief agreements will presumably be worked out before hostilities end. Wartime commodity agreements designed for other purposes will presumably be brought into harmony with this policy.

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between the Allied Governments and authorities in consultation, as and when appropriate, with other Government concerns [*sic*].

"6. That, as a first step a bureau should be established by His Majesty's Government in the United Kingdom with which the Allied Governments and authorities would collaborate in framing estimates of their requirements and which, after collating and co-ordinating these estimates, would present proposals to a committee of allied representatives under the chairmanship of Sir Frederick Leith-Ross."

[1] *Inter-allied Review*, Oct. 15, 1941, p. 7.

[2] *New York Times*, Oct. 8, 1941, p. 14.

[3] *Department of State Bulletin*, Feb. 28, 1942, p. 192.

Many such agreements may well pass through provisional drafts before they are ready for adoption. Nutritionists and students of food habits, as well as commodity, financial, shipping, and political experts, will need to work over the drafts if serious mistakes are to be avoided. Some agreements may be signed to take effect when the war ends and be revised as circumstances change in the interim.

Reconstruction problems will accompany and follow those of relief and human rehabilitation. How can various commodity stocks and new supplies under government control be handled so as to lessen the shocks of transition to peace, to hasten reconstruction, to facilitate the conversion of industrial capacity from war to peace uses, to create new jobs to absorb men and women released from military activities and war industries? With such objectives, resort may well be had to special types of international commodity agreements,[1] and wartime agreements may be appropriately modified or supplemented with such temporary objectives, though independent action on lines of agreed general policy may be found adequate in many cases. As the recent League of Nations report states, "the maintenance of various forms of economic control will be necessary, in some cases for a considerable time, after the war."[2]

Nevertheless, at various points all such relief and readjustment agreements will be influenced by dominating ideas regarding the shape that the postwar world is to take after the transition period. Obviously, all such agreements should facilitate recovery to a new normal, far superior to the abnormal prewar position. But what sort of normal shall be aimed at?

SOME BASIC CONSIDERATIONS

For the peace period proper, one consensus seems in process of crystallization: the normal, over-all objective of individual effort and social policy—local, national, and international—is the persistent if irregular advance in planes of living, for families, communities, states, and mankind, according to their several standards and preferences except as these may endanger advances elsewhere.

We need not hitch our wagon to a star. We cannot realistically expect early attainment of uninterrupted peace, optimum nutrition,

[1] It was with such an objective that the late F. W. Taussig suggested, late in October, 1918, setting up a central board of control and allotment of raw materials, to minimize tensions in the postwar transition period. Redvers Opie, "Frank William Taussig (1859–1940)," *Economic Journal*, Vol. LI (June-September, 1941), pp. 362–363.

[2] *New York Times*, Aug. 10, 1942.

perfect health, full personal security, universal enjoyment of two, four, or more "freedoms," or equalization of living planes at peaks somewhere reached. But neither need we set our aims low. Outstanding progress in these directions will be possible, after war's devastation ceases. The world's productive powers are larger than we have realized, and at least *potentially* larger per capita than ever before. The world's people have urgent needs, clamorous wants, for more and better commodities, services, and spiritual environment than they have yet enjoyed. Obviously, the basic task is to utilize abundant productive power, more fully and more consistently than hitherto, to satisfy these needs and wants and others that will arise as they are being gratified.

Cynics may scornfully ask: "What is progress? Can we agree on how to define it, measure it?" Maybe not, but must we? Some signs we may misread, but surely we are safe in accepting various indicators of undoubted human progress. Diminution of slavery, serfdom, peonage, and their counterparts; decline in infant mortality and the general death rate; shorter hours of labor and lessened drudgery; reduction of illiteracy; increasing safety and variety in food; abundance of soap and its newer alternatives; more comfortable and healthful living quarters; wider availability of recreational facilities and social services: these are a few of many such indicators from which a trustworthy index will some day be computed.

Advance in living planes is not identical with rise in consumption levels.[1] Some would live better if they consumed less. For the mass of men, however, increased per capita consumption is an essential condition of better living. The possibilities seem vast, especially now that history has forced radical modification of Malthusian doctrines. If a modern economy temporarily stagnates, the reason must surely be found elsewhere than in lack of true capacity either to consume or to produce.

In the worldwide advance of planes of living may perchance be found what William James once called the "moral equivalent of war." In any event, it makes a powerful appeal to the vast majority of mankind, in advanced and backward countries alike, as the leaders have belatedly recognized. Interlocking but essentially subsidiary objectives include widening the range and lengthening

[1] I have discussed this distinction, and the relation of levels and planes to "standards" proper, in a note in the *Journal of Marketing*, Vol. VI (October, 1941), pp. 164–166.

the duration of peace, moderating tendencies toward widespread and violent economic fluctuations, enlarging the volume of international and interregional trade, and perfecting methods of employing all, even the handicapped, who want to work or whose work is needed.

Others may envisage a very different over-all objective of peace-time effort and policy. But if I have set forth, however crudely, the truly normal one, the first criterion by which to judge the social desirability of any specific type or example of international commodity agreements is this: Does it aid or hinder the progressive rise of consumption levels and advances in living planes?

Other legitimate aspirations of many nations must be reckoned with. One of these is the claim of the so-called *have-not nations* to free and equal access to raw materials and foodstuffs, at least to the extent that these are not used to plunge the world again into war. This vital issue is cautiously dealt with in point 4 of the Atlantic Charter, which committed the United States and Great Britain to an endeavor, "with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity." The implications of honorable fulfillment of this pledge must be worked out. We need satisfactory answers to such questions as this: Can such free access be assured (*a*) if great wealthy powers pursue policies that seriously limit the purchasing power of other nations for imported goods, and (*b*) if exports are restricted by quotas and other price-raising devices? Mr. Welles well said:

> The basic conception is that your government is determined to move toward the creation of conditions under which restrictive and unconscionable tariffs, preferences, and discriminations are things of the past; under which no nation should seek to benefit itself at the expense of another; and under which destructive trade warfare shall be replaced by cooperation for the welfare of all nations.

Foreign Secretary Eden earlier said much the same thing,[1] and

[1] In Parliament on May 29, 1941, he declared that Great Britain will effect such arrangements after the war "as will permit the revival of international trade on the widest possible basis. We shall hope to see the development of a system of international exchange in which the trading of goods and services will be the central feature . . . let no one suppose that we, for our part, intend to return to the chaos of the Old World." Quoted in George Peel, "Mr. Eden v. Dr. Clodius." *Contemporary Review*, August, 1941, p. 95.

Secretary Hull elaborated it in his eloquent radio address of July 23, 1942.[1]

Another central question presses for answer: Shall the postwar peacetime world be broadly characterized by freedom of private enterprise or by far-reaching government operation and controls? Some consider irresistible and irreversible the drift or drive in the latter direction, or else account desirable not the liquidation of wartime agencies but their conversion into peacetime agencies of like character, or revere "planning" and regard it as essentially implying vast extension of such measures in peace. Granting the fact of a long-term trend toward enlarging the economic sphere of governments, I wish to suggest grounds for questioning these views.

Modern wars, and preparations for them, inevitably force expansion of governmental activity in the economic sphere. Production must be diverted to defense and offense at the expense of individual consumption, freedom, and leisure. To achieve this major if abnormal objective, commodity scarcities must be coped with and even enforced, quickly and equitably; and for this government action is essential, with resort to priorities, allocations, rationing, price fixing, and government purchase and sale. But such moves mainly represent deviations from trend, not the trend itself or a new one. Powerful reactions from such deviations occurred after the First World War. In spite of wartime concentrations, entrenched bureaucracies, and convictions of some responsible statesmen, something comparable may be expected after the Second World War, in some countries if not everywhere.

The ends of peace call not for continued constraints on consumption and leisure, but rather for expansion of both, in infinitely varied, unstandardized forms, in aid of what Vice-president Wallace has rightly called "the more abundant life," including economic security in reasonable balance with liberty and progress. Where diffusion of commodity abundance is called for, I venture to assert, government controls beyond certain limits tend to interfere with effective distribution and maximum consumption. Except possibly under a dictatorship, moreover, government regulation of production and surplus stocks has thus far proved difficult, costly, and uneconomic, and there are reasons for thinking this not merely temporarily but well-nigh inevitably so. Private enterprise and initiative, subject to limited regulation and supplemented by government action in restricted subject areas, promise far more effective

[1] *New York Times*, July 24, 1942.

contribution to higher living planes than does maintenance of public "controls" at or near wartime levels. We shall be shortsighted if we embrace the theory that "the age of enterprise has given place to the age of security."[1]

More and better planning, in the literal sense of the term, is essential if the problems ahead are to be well solved. But I reject the view that planning—local, national, or international—necessarily implies extension of government controls ad infinitum. It properly includes measures to promote and facilitate private enterprise under restraints mainly of the traffic-regulation type. Freedom of incorporation under general corporation acts represented planning even more than did multifarious special charters. Reciprocal trade agreements, designed to lower barriers to commerce, represent planning no less than the Hawley-Smoot Tariff Act of 1930. Nowadays, indeed, removal of obstacles to international trade may take more planning than adding fresh obstacles. Measures to facilitate enterprise, competition, and other constructive economic forces represent planning quite as much as measures to subsidize cuts in crop acreage or destruction of coffee at national expense. Prevailing misconceptions, cultivated by ardent devotees of national and international *planning*, have brought even a good term into disrepute in balanced minds.

Which school of thought, if either, will dominate after the armistice, and where, I cannot predict. Divergent views appear to coexist within our present government and the British. The director of our Office of Foreign Agricultural Relations wrote in October, 1941:

> The eight-point statement signed at sea by President Roosevelt and Prime Minister Churchill formalized, among other things, the conviction that if this war is to lead to a sounder relationship between the nations of the earth, then international trade must be so regulated as to minimize destructive economic rivalries.[2]

This, in its context, is strongly at variance with my own reading of both the Atlantic Charter and relevant passages in Secretary Welles's contemporary address and Secretary Hull's more recent one. Mr. Hull merely conceded: "There may be need for some special trade arrangement and for international agreements to

[1] *The Economist* (London), Vol. CXL (June 14, 1941), p. 784.

[2] L. A. Wheeler, "Agricultural Surpluses in the Postwar World," *Foreign Affairs*, Vol. 20 (October, 1941), p. 87.

handle difficult surplus problems and to meet situations in special areas." British official spokesmen have in general expressed views similar to those of Mr. Welles and Mr. Hull. On the other hand, it is not surprising to find Sir Stafford Cripps saying, in his address of July 25, 1942:

> One thing is sure—that the United Nations must, at the end of the war, undertake the international regulation of the production and distribution of essential raw materials, both in the interest of immediate rehabilitation of the devastated countries as well as with a view to attaining that steadily rising standard of living throughout the world which is one of our objectives.[1]

The issue remains to be determined, but no convinced believer in a liberal versus some form of socialistic policy need prematurely take a defeatist position.

EXPERIENCE AND OUTLOOK

The largest group of international commodity agreements, mostly bilateral, are part of the political and economic machinery of rearmament, defense, and war. Such were most of Germany's prewar commodity agreements, within and outside Europe; and those between Britain and the United States with the objective of building special reserves of wheat and cotton there, of rubber here, and of wool in both countries. Such also are the wartime agreements between Britain and her dominions and Argentina with respect to wheat, wool, beef, lamb, pork, and butter; and our agreements with individual Latin American countries for purchase of their output of strategic materials. Most such agreements, I assume, will either be liquidated after the present war, as others were after the First World War, or be merged into the type next to be discussed.

The more representative multilateral international commodity agreements have been concerned with regulative restriction of export and/or production of staple raw materials and foodstuffs, such as rubber, tin, sugar, wheat, tea, and coffee. Experience with these has been short and, in general, admittedly unsatisfactory. Some broke down soon; some have worked, for better or worse; some have satisfied their members without clearly passing "social" tests.[2] Several existing and proposed agreements represent

[1] *New York Times*, July 26, 1942, p. 18.

[2] Most of these have been subjected to careful examination by various competent scholars of several nationalities; and my colleagues and I have in hand a coordinated study of both experience and potentialities.

attempts to buttress costly and vulnerable national commodity "controls." All represent a special manifestation of the traditional tendency to protect existing investments or coddle producers, in this case by international sponsorship of price-supporting restraints of trade such as monopolistic business frequently resorts to. Often they protect the strong against the weak, and restrict competitive adjustments making for lower production costs, instead of promoting consumption. By and large, they have constituted elements in an increasingly complex system of restrictions on production, international trade, and consumption. Of this whole system, but without specific reference to commodity controls, Mr. Welles rightly said: "There exists the danger, despite the clear lessons of the past, that the nations of the world will once more be tempted to resort to the same misguided policies which have had such disastrous consequences."

There are those who hope or expect that a whole network of international commodity agreements will be devised and adopted that will be free of such recognized defects.[1] It is perhaps conceivable that such agreements might be so made as to raise consumption levels generally, ensure free access to raw materials, facilitate international trade, reduce economic fluctuations, and promote full employment. This ambitious scheme deserves earnest study; but the time is unripe for blithe commitments in advance of thorough, unprejudiced investigation. Broad principles, efficient techniques, and sound administrative procedures have yet to be worked out, and relevant commodity researches are as yet poorly developed.

For broad principles we must surely go beyond favorite devices such as export quotas, and beyond catch phrases that are, for the most part, plausible camouflages. In practice, "stabilization of prices" commonly means boosting prices above equilibrium levels,

[1] *Cf.* "Commodity Control Schemes," *Planning* (a broadsheet issued by P E P, London), No. 174, July 29, 1941.

In August, 1938, J. M. Keynes sketched a proposal that commodity stocks be held, with aid from the public treasury, in order to moderate extreme fluctuations of commodity prices in time of peace. "The Policy of Government Storage of Food-stuffs and Raw Materials," *Economic Journal*, Vol. XLVIII (September, 1938), pp. 449–460. Commenting on his proposal, the London *Economist* (Aug. 20, 1938, pp. 353–354) pointed to unsatisfactory past experience but added: " . . . It should not be beyond human ingenuity to discover means of doing successfully in the general interest what has hitherto been done with indifferent success in one interest alone. And in any such system of commodity control, the public holding of stocks will play an essential part."

not moderating fluctuations around an economic level. "Fair" or "parity prices" are undefined or politically defined, typically well above economic normals, perhaps on ill-judged historical bases rather than on economic grounds. "Fair shares in world trade" are set by bargaining with historical averages, rather than with respect to current ability and willingness to compete. "Production control" means attempted restrictions of acreage or output, in such ways as keep high-cost units in operation and otherwise raise average costs. "Ever-normal granaries" represent stocks far above economic normals, manipulated to support prices rather than maximize consumption, and with political pressures interfering with effective disposition. "Destructive economic rivalries" usually mean vigorous normal competition.

Commodity analysis, far more adequate than hitherto, is also essential if serious mistakes are to be avoided. The characteristics of each commodity concerned need to be fully explored. To a degree of which few economists are aware, wheat is not simply wheat, or coffee coffee. Rubber, tin, wheat, coffee, and sugar differ greatly in their vulnerability to displacement by alternative goods and in their potentialities for increased consumption. Conditions of demand, supply, and consumption need to be far more fully understood, and in particular the responsiveness of production and consumption to changes in price, income, and business activity. Congeries of crude ideas require testing and restatement, in respect of actual burdens and benefits from holding and release of stocks, attempts to regulate production, and measures to improve world nutrition. The plausible but inadequate and often seriously misleading summaries in reports by various government officials and agencies need to be replaced by unbiased studies by competent scholars who are free to seek, find, and speak the whole truth.[1]

Crucial questions press for answer in connection with planning such agreements for a world at peace. A preliminary one is this: Can such agreements really be reached among the nations truly concerned, be modified as conditions change, and be kept, without resort to dictatorial methods? Experience renders this highly improbable for the types of agreements that are most commonly contemplated, but not necessarily for all types. Other questions

[1] For one recent example, compare the annual reports and press releases of the Federal Crop Insurance Corporation with the recent study by J. C. Clendenin, "Federal Crop Insurance in Operation," *Wheat Studies of the Food Research Institute*, Vol. XVIII (March, 1942), pp. 229–290.

that suggest both obstacles to be overcome and principles appropriate to be observed are these:

Is it possible to reach and maintain essential harmony between numerous commodity agreements in continual flux?

Can such agreements be expected to facilitate or thwart technological progress and adjustments in the *status quo* between nations and between competing commodities?

Can agreements be reached on price levels that will tend to promote consumption instead of restricting it?

How far is price stability truly advantageous? Can international commodity control agencies be trusted to facilitate needed price reductions as well as price advances?

Insofar as agreements succeed in price-maintenance objectives, will it be possible to avoid distortion of the world's productive resources, and cumbersome regimentation of overstimulated production?

Can such agreements effectually ensure free and equal access to foodstuffs and raw materials wanted by deficit countries?

Can they be made consistent with such policies as our own with respect to reciprocal trade agreements, or do they inevitably involve multiplying obstacles to the flow of goods?

Should a system of commodity controls be used to prevent piling up of reserve stocks by potential aggressors, and as machinery for economic sanctions?

Can political pressures of various kinds be prevented from wrecking the economic functioning of the schemes?

Much is to be lost, and nothing gained, by ignoring or glossing over such problems, or plumping for widespread resort to politico-economic machinery of which sample tests have revealed shortcomings galore. Along that road lie disillusionments, even disaster. Excessive ideas as to prices, and political interference designedly in the interests of producers, have been the most typical sources of failure in both national and international controls.

Our own experience with wheat, in 4 years of operation under the Agricultural Adjustment Act of 1938, is tragically illuminating. Acreage restriction, bought by Federal subsidies latterly reinforced by miscalled "marketing quota" penalties, has worked only within the limits that Congress has permitted, and to call the result "production control" is absurd. In the name of an "ever-normal granary," and despite subsidized exports and surplus disposal, carryover stocks have risen from a reasonable level of 153 million

bushels in 1938 to a prospective total of 800 million in 1943. Even now, Congress limits the disposal of government-owned wheat for urgently needed feed uses. Much more storage space must now be provided, at the expense of the war effort. As wheat supplies have sharply risen, prices have been forced up by government purchases, mostly in the guise of Federal loans at successively higher rates, while high returns to growers are augmented by other Federal checks. No official dares publicly to estimate the full cost to the Federal treasury and the nation, and none has proposed a way out of the impasse. While what were deemed "positive measures" to solve the wheat-surplus problem have been in force, it has grown to dimensions hitherto undreamed of. Yet the international wheat agreement effective June 27, 1942, and the Draft Convention that accompanies it,[1] seem heavily based on the assumption that the United States has mastered the relevant arts.

Promising experience with and possibilities for different types of international commodity agreements should be fully explored. The Brussels Sugar Convention of 1902 ended for a time what had proved uneconomic and unfair practices—export dumping of sugar following overstimulation of beet-sugar production in several European countries. Less important and less successful, but not wholly unpromising, have been a few agreements to eliminate obstacles (such as heavy export duties) to the international flow of specific goods. More significant, within limited scope, have been agreements with respect to fur seals, halibut, sockeye salmon, and whaling, which have sought to check serious depletion of valuable marine resources and bring about their replenishment instead.[2] Most of the limitations upon unrestrained competition involved are essentially comparable with the traffic regulations that have facilitated enormous growth of transportation by land, water, and air.

The marine-resource agreements have revealed the special importance of intensified scientific research, focused on both underlying problems and appropriate regulatory measures; but even in these cases there has been inadequate parallel research on economic and political aspects. Far more effective recognition should be

[1] *Department of State Bulletin*, Aug. 1, 1942, p. 670. I have explored this subject, and examined these documents in some detail, in the November, 1942, issue of *Wheat Studies*, entitled "New International Wheat Agreements."

[2] The Food Research Institute will shortly publish a book on this subject, *International Agreements on Conservation of Marine Resources*, by Jozo Tomasevich.

given to the importance of such well-focused, well-financed research in connection with the formulation, operation, and modification of other agreements. Insofar as resort is had to international commodity agreements, ample provision ought to be made for objective, expert, continuous study of their structure and operations, and their effects on the world economy and international political relations, to assist in correcting major errors of policy as well as blunders in detail.

Some agreements, like the sockeye-salmon agreement now in limited operation, may well be essentially investigatory, at least initially. One promising subject is beef. This concerns not merely Argentina, Britain, and the United States, but a number of other countries. Beef has been a source of international friction. Potentially it has contributions to make to better nutrition and consumer satisfactions. The actual demand for beef is notably income-elastic, and in the world as a whole there is a huge potential demand. The time is not ripe for any multilateral international agreement designed to promote maximum economical production and consumption of beef. There is, however, urgent preliminary need of studies by specialists in animal diseases (especially hoof-and-mouth disease), agricultural and animal husbandry, geography, nutrition, several branches of economics, and political science. Why not put them to work in coordinated fashion? The countries chiefly concerned might set up a small commission to organize a well-balanced body of able experts to study all the complicated issues involved—if need be for several years—with the task of finding, organizing, and analyzing the relevant facts and opinions, and clarifying the issues, so that eventually an intelligent program of practicable solutions could be drafted.

To conclude: A proper field for international commodity agreements suitable to a free world at peace can be found. I regard not as hopeless, but as moderately hopeful, the search for methods of international cooperation, agreement, and even regulation that will genuinely promote peaceful progress of the world economy. Yet too much current thinking is vitiated by carryovers from the decade of the 1930's, when desperate efforts to combat depression were accompanied by widespread economic measures in preparation for war. A new orientation is needed. Larger vision, and critical and constructive thinking, are essential to formulate the principles and to perfect the devices appropriate for a world rededicated to freedom and progress.

PART VII

International Economic Relations

Chapter XIX

THE POLITICAL ECONOMY OF REGIONAL OR CONTINENTAL BLOCS

Gottfried Haberler

INTRODUCTION

This essay deals with the following questions: Is it easier, more promising, and desirable to build the international organization of the world on the basis of independent states—those states which we find on the map of, say, 1937—or should the individual countries be grouped in regional or continental blocs or federations which then could be organized more or less tightly or loosely in a worldwide superstructure? To put the question the other way around: suppose that some machinery for international cooperation on a worldwide scale, like the League of Nations, is set up; should it be based on regional blocs or on independent states? Are the small countries capable of living at all? Is it not essential for their *economic* survival—not to mention political and military considerations—that they consolidate themselves in larger units or join groups led by big powers? Using a somewhat philosophical—or should we say flowery?—language, we might say: should the world be organized on an "atomistic" basis (taking the states existing in, say, 1937 as the atoms) or on an organic one?

The view that the latter is the "natural," preferable, and more promising solution is by no means confined to writers in totalitarian countries, who wish to build up their respective blocs or "living spaces" and to organize the world in a few power spheres of continental dimensions. In the democratic countries, too, the view is frequently expressed that the organization of the world should be developed from below by the formation of regional federations or blocs, and these views are supported by economic, political, and military reasons.

We shall discuss mainly the economic aspects of the problems; but since, in this field, economic, political, and military factors are closely and intricately interrelated, the discussion of the economic

aspects cannot be carried on in a political vacuum; assumptions about certain political realities and expediencies must be clearly stated.

THE POSSIBLE ECONOMIC CONTENT OF REGIONAL FEDERATIONS

In detail, there is an infinite variety of possible contents for an economic federation of countries. The most important and most frequently discussed subjects for collective regulation are (*a*) movements of goods, (*b*) migration of men, and (*c*) monetary standard and policy and the flow of capital and credits. A complete economic unification of two or more countries would apply to all three subjects, implying free trade, free migration, common currency arrangements, free flow of funds, and synchronized monetary and credit policies. A federation can, however, be restricted to certain fields, and in each field a different degree of intimacy of interrelation may obtain. If two or more countries introduce free trade for goods among themselves while maintaining restrictions against imports from the outside world, we speak of a complete customs union. If duties on internal trade are not completely abolished but only reduced as compared with duties on imports from the outside, we speak of an incomplete customs union or of a preferential tariff regime, the difference between the two being one of degree rather than one of kind.[1]

The establishment of freedom of migration has been little discussed and proposed except as part of a complete economic unification which would also imply a customs and monetary union. It is much harder to achieve a removal or reduction of barriers to migration than of barriers to trade. While, conceivably, certain countries might agree on freer or free trade and on a common monetary policy without at the same time loosening restrictions on migration, it is almost inconceivable that free migration should be introduced and at the same time tariffs maintained.[2] In fact, the obstacles to free or

[1] There are many cases of preferential tariff arrangements; *e.g.*, the empire preferences between the members of the British Empire, the case of preferential duties on imports to the United States from Cuba, Hawaii, the Philippines, etc. Many others were proposed and discussed and a few introduced (*e.g.*, in Central Europe) during the interwar period.

[2] Contrary to popular misconceptions, the economic argument for free trade does not necessarily presuppose free migration. Apart from special cases, free or freer trade is profitable even if migration is not free. In fact, in many cases the lack of freedom of population movement strengthens the case for free trade. For densely populated countries, like Great Britain or Belgium, trade is a matter of life and death precisely because the people cannot emigrate. To some extent the movement of goods is a substitute for the movement of people.

freer migration are so formidable, so much greater than those to free or freer trade, that it may well be argued that the question should be dropped altogether or at least not linked with the question of freeing the movement of goods in order not to jeopardize the chances of achieving something in the trade field.[1] For this reason, as well as for reasons of space, we shall not deal with the migration problem in the following pages.

Cooperation or unification in the field of money and banking can be effected in very different forms and degrees.[2] The layman will think in the first place of the establishment of a common monetary unit. The Latin Monetary Union of the prewar days is for him the ideal type of monetary internationalism. In reality, equality of the currency unit is an unimportant technical detail. If two countries have dissimilar monetary units, *e.g.*, pound and dollar, but if their exchange rate (relative value of the two currency units) is fixed by an appropriate policy, the countries may be just as closely coordinated as if they had the same currency units. What matters is the rules of policy which guarantee the fixity of the exchange rate. Both the countries may be on a gold standard, or one may be on an exchange standard pegging the value of its currency to the currency of the other. Or the relationship may be still more intimate, the two countries having agreed to support one another by extending credit, if necessary.[3] In the pre-1914 years, and to some extent during the interwar period, the same effect was achieved automatically by the mechanism of interrelated money markets and the free flow of funds in response to small differences in interest rates. There is, however, no general agreement between experts as to whether fixed exchanges are the best method of international monetary cooperation. Many economists believe that it

[1] Just think of the chances of persuading the people of the United States, Australia, or any other country with a high standard of living to permit the free immigration of Chinese (not to speak of Japanese) labor after the war! Also, from a selfish point of view of the country or of large groups (*e.g.*, labor) in the country into which immigration is to take place, much more serious objections can be raised against free immigration than against the free importation of goods. (Cf. Prof. Lerner's essay in this volume.—Editor.)

[2] A more systematic discussion of types of monetary cooperation will be found in Ch. 12, §4 (pp. 425*ff.*) of my *Prosperity and Depression* (2d and 3d eds., Geneva, 1939 and 1941). See also John H. Williams, "International Monetary Organization and Policy," in *Lessons of Monetary Experience* (New York, 1937), and Albert Halasi, "International Monetary Cooperation," in *Social Research* (May, 1942).

[3] A small step in that direction was made in the tripartite agreement of 1936 between the United States, Great Britain, and France.

is sometimes easier to bring about necessary price adjustments by changing the relative values of two currencies rather than by price changes in one or both of the countries concerned.[1] Suppose, for example, a shift in demand of one region for the produce of the other (due, say, to a good harvest or a bad one or an industrial change or a change in consumers' taste). If the two regions belong to the same country and have the same currency, or if they have dissimilar currencies but are rigidly linked together by a common standard (*e.g.*, gold standard), then incomes, prices, and purchasing power must fall in the one country and/or rise in the other in order to restore equilibrium.[2] Such a deflation entails at least temporary depression and unemployment. Now the *monetary nationalists* argue that what is required is only a *relative* change in incomes and prices as between the two countries, and that this can be brought about more smoothly and speedily by adjusting the relative value of the two currencies than by reducing prices in one and raising them in the other country. It would follow that complete unification of the currency between countries is not desirable because it eliminates the possibility of varying the exchange rate.

There is no room here to argue at length the merits of the two proposed solutions.[3] The above discussion only serves the purpose of showing that monetary cooperation or federation may mean very different things for different people.[4]

[1] Those who hold this view have been called by their opponents *Monetary Nationalists*. To this school belong Lord Keynes and his followers, S. E. Harris (*Exchange Depreciation*, Cambridge, Mass., 1936), C. R. Whittlesey (*International Monetary Issues*, New York, 1937), and many Swedish economists. Staunch *monetary internationalists* (according to their own description), *i.e.*, advocates of fixed exchanges, are F. A. Hayek (*Monetary Nationalism and International Stability*, London, 1937), L. Robbins (*Economic Planning and International Order*, London, 1937, Ch. X, and "Economic Aspects of Federation," in *Federal Union*, ed. by M. Chaning-Pearce, London, 1940, pp. 176–180), and M. A. Heilperin (*International Monetary Economics*, New York, 1939).

[2] Temporarily, all this may be obviated by letting gold flow out or by the extension of credit on the part of the other country.

[3] As Prof. Robbins has stressed (see his "Economic Aspects of Federation," *loc. cit.*), the monetary nationalist has the difficult task of demonstrating why it should be desirable for, say, Canada and the United States to have different currency systems, but not for, say, the state of New York and the state of Pennsylvania. Where must we draw the line? What is the difference between "county" and "country"?

[4] However, on certain basic postulates, expert opinion is well agreed. Monetary cooperation should eliminate competitive or predatory exchange depreciation, provide for consultation before any act of depreciation, etc.

In the comparatively liberal era up to 1914, and even during the interwar period until the outbreak of the great depression, it was possible to deal with the two areas—tariffs and monetary arrangements—separately and to reduce either one to simple formulas: reduction or abolition of tariffs on the one hand, and fixity or variability of the exchange rate on the other. Neither of these two procedures will be possible in the future unless the trend in economic policy, domestic and international, toward greater and greater interference by the governments—a tendency which has been enormously accelerated since the great depression of the thirties—is radically reversed; and this is not likely to be the case. The regulation of international trade by tariffs, quotas, and other measures has become very complicated; trade policies and international monetary and credit policies have been more and more closely integrated in most countries; protection and exchange control, the regulation of the flow of goods and of payments and money, are now everywhere so designed as to support one another. And this comprehensive control of international economic relations is everywhere integrated and linked with domestic policies.

One consequence of this state of affairs is that economic cooperation or federation cannot be defined simply in terms of low customs duties and a stable exchange rate. There would be little use in agreeing on low tariffs if the other partner could always nullify such an agreement by exchange control measures or by suasion or coercion of producers and traders which would prevent them from buying foreign products. The United States has had a foretaste of these complications in connection with reciprocal trade agreements with countries that had advanced in the art of totalitarian economic control.[1] It became necessary to deal in commercial treaties with a lot of subjects which formerly were entirely outside of international negotiations and commercial treaties. Similarly, future economic cooperation and federation will have to be conceived of in terms of many more things than customs duties, exchange rates, and international credits. Domestic industrial control measures, transportation and labor policies, public spending and taxation, price control, and many other things will have to be considered and agreed upon; if these domestic policies are not somehow coordinated, an agreement on tariffs will be futile and situations will frequently arise which make tariff agreements untenable.

[1] *Cf.* Henry J. Tasca, *The World Trading Systems* (Paris, 1939).

Space does not permit an exhaustive discussion of these questions in all their complexity. We shall begin by discussing the problem in terms of tariffs, taking the word to include all sorts of trade restrictions (quotas, prohibitions, exchange control, etc.), and assuming that nullifying or disturbing domestic policies are excluded, either by mutual agreement concerning their coordination or by a return to more liberal practices. In the last section, some implications of the general tendency toward central planning for our specific problem will be analyzed.

THE CASE FOR LARGE ECONOMIC UNITS

From a purely economic point of view—*i.e.*, taking maximization of the national income as the sole end and disregarding military and political considerations—the economic arguments for the formation of regional blocs are identical with the old classical arguments for free trade. Small countries are uneconomical because the markets which they supply are not sufficiently large to make possible their enjoyment of the advantages of mass production and of full division of labor. The modern development of techniques of mass production, which entails a tremendous increase of the optimum size of plant in many lines of production, and the improvements in transportation technique, which brought about larger and larger market areas and increased the scope for a profitable exchange of goods, have augmented the handicaps of the small countries compared with the large. That this reasoning is substantially correct is almost universally agreed among economists. Most experts believe that there are exceptions to the rule, *i.e.*, that there are conditions under which protection from foreign competition is economically defensible. Some of the best arguments for protection, however, do not apply against a *mutual* reduction in duties; they apply only *against* unilateral reduction (and, hence, *for* unilateral imposition of duties). But the formation of larger economic areas on a regional basis implies, of course, a mutual and not a unilateral abolition or reduction in trade barriers. Other defensible arguments for protection are essentially short run; they are concerned with the difficulties and losses of the transition that could be avoided by a suitable policy of gradual change.

Without a doubt, the free-trade reasoning applies to complete customs unions of contiguous countries. If regional or continental economic blocs are formed by abolishing duties between the mem-

bers of the group, the participant countries will be enabled to enjoy the benefits of mass production and more extensive division of labor.

The economic situation is, however, by no means so clear in the case of incomplete customs unions. If duties between the members of the group are not abolished but only reduced, *i.e.*, if the members of the group grant one another preferential treatment, the economic gain is questionable. The difference between the two cases is not one of degree only; in other words, a preferential low tariff regime is not simply less beneficial than a complete customs union, though still an improvement over the old arrangement.[1] It can be shown that preferential duty reductions are frequently valueless or positively injurious. The argument has often been used by the proponents of preferential regimes that a partial (*i.e.*, preferential) duty reduction is better than none at all, even though it is conceded that a general reduction (not confined to the imports from certain countries) would be still better. This argument has been shown to be incorrect,[2] at least in many cases; a partial duty reduction is not only not always better but frequently worse than no reduction at all.

The reason for that can be made clear by means of an actual example from American tariff history, which was statistically examined and evaluated in the writings of F. W. Taussig and the United States Tariff Commission (under Taussig's chairmanship).[3] Suppose that the United States should reduce the duty on sugar. Imports will rise, the sugar price will fall, the consumer will benefit, and, eventually, factors of production will be shifted from sugar production to other places where the product is larger.[4] Now

[1] It goes without saying that, if a preferential regime is brought about not by reducing duties between the member states but by raising them against the outside world, it constitutes a step backward from the free-trade point of view. But this is not the case contemplated in the text.

[2] *Cf.* F. W. Taussig, "Reciprocity," *Quarterly Journal of Economics* (October, 1892), reprinted in *Free Trade, the Tariff and Reciprocity* (1920), pp. 120*ff.* See also Taussig, *Some Aspects of the Tariff Question* (3d ed., Cambridge, Mass., 1931); U. S. Tariff Commission, *Reciprocity and Commercial Treaties* (Washington, 1919), pp. 103–136; J. Viner, "The Most-favored-nation Clause," *Index* (ed. by Svenska Handelsbanken, Stockholm, 1931); Jacopo Mazzei, "Kritische Betrachtungen zur neuzeitlichen Handelspolitik," *Weltwirtschaftliches Archiv*, Vol. 37 (1933), pp. 12*ff.* G. Haberler, *The Theory of International Trade* (London, 1935), pp. 385–390, and *Liberale und planwirtschaftliche Handelspolitik* (Berlin, 1934), pp. 61–71.

[3] See preceding footnote.

[4] If factors are immobile and their prices rigid (as they frequently are, espe-

suppose that the duty is reduced only preferentially for imports from certain countries, *e.g.*, Cuba. If this privileged country cannot fill the import needs of the United States, sugar will still be imported from nonprivileged countries, say, from the world market. Suppose now that the world market is large and the world market price practically independent of the American purchases; then the American domestic price will not change at all. It will still be at the level of the world market price plus the unchanged duty from countries outside the privileged area. There will be only a shift of imports from the world market to the privileged country. The American consumer is not benefited, the domestic sugar producers are not affected, no shift of production resources takes place, but the United States Treasury loses a part of its receipts from the sugar duty because Cuban sugar pays less than before. The preferential duty reduction turns out as a subsidy by the United States Treasury to the Cuban sugar producers and is to that extent a clear loss for the national economy.[1] The case need not be so extreme, of course. The preferred country may be the principal source of supply. Then the sugar price will fall. But in that case there is no reason why the concession should not be generalized. Very frequently, however, especially in central and eastern Europe during the interwar period, duty reductions on a preferential basis have been granted precisely for the purpose of avoiding price repercussions. To make doubly sure that total imports would not rise and domestic prices fall, the preferences were frequently limited to comparatively small quotas. The result was that, *e.g.*, Austria, Germany, Italy, imported more grain from eastern Europe and less from overseas. These kinds of preferences cannot be defended on ordinary free-trade grounds; they certainly offer no way out of the maze of protectionism.[2]

GENERAL VERSUS REGIONAL REDUCTIONS OF TRADE BARRIERS

These worthless or even injurious preferential duty reductions we may leave out of consideration altogether and concentrate

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cially in the short run) the benefits from free trade may be illusory. But this complication is irrelevant for the issue at hand and need not detain us here.

[1] There may be indirect gains and advantages of a political or economic nature.

[2] Some slight qualifications of these statements are necessary. See my *Liberale und planwirtschaftliche Handelspolitik.*

on substantial reductions of trade barriers that have a positive value.

If a case can be made for a regional reduction in trade barriers, a still better one holds for a general reduction. What is then the reason for advocating regional blocs rather than universal free or freer trade? In practice, the reason was frequently nothing but the wish to increase exports without increasing imports. Countries were willing to grant special privileges to other countries, carefully limited to small quotas, because they wanted to export more without increasing imports. Total imports were to be kept unchanged by importing less from nonprivileged countries. Many proponents of preferential blocs were under the naïve illusion that the preferential system provided a means of reaping the advantages of free trade without hurting anybody, a way of increasing the volume of trade without any reshuffling of productive resources and without any pains of transition. We need not spend time on such notions.[1] But they accounted for much of the popularity of the preferential idea among politicians and statesmen, which found expressions at innumerable international economic conferences during the interwar period.

A complete customs union, however, is a different matter. It implies an extension of the division of labor and a reshuffling of productive resources. If introduced abruptly it would create severe disturbances of transition. And even in the long run, it must hurt individual interests, although, according to accepted

[1] From the short-run point of view a policy whereby two countries grant one another preferential duty reductions limited to certain amounts (quotas), so as to make sure that total imports do not rise, may have a certain stimulative value. Each country increases its exports; total imports are kept unchanged by cutting down imports from third countries. This is equivalent to a policy of export subsidization by the two governments, which should have approximately the same effect as public works expenditures of the same magnitude, with the exception that it is injurious to third countries, *viz.*, to those from which imports are reduced.

It is interesting that in some cases preferential duty reductions were actually concealed as export subsidies (which again were clothed in the form of export credits at especially low interest rates). This was done by Austria, Italy, and Hungary. The reason for that clever masquerade was the wish to evade most-favored-nation claims of third powers. If duties had been reduced, third countries could have asked for similar duty reductions in fulfillment of most-favored-nation pledges given to them in commercial treaties. But countries do not like having imports into their territory subsidized, and hence would not ask for subsidies of other countries' exports on the strength of the most-favored-nation clause!

principles of international trade, the national income as a whole will rise after the necessary adjustments have been made. The difficulties in the short run, and the opposition of employers and workers in those industries which have to contract, will be in principle the same as those encountered by an attempt to introduce free or freer trade in general. (General free trade is equivalent to an all-round customs union.) What, then, is the advantage of striving for regional customs unions rather than for freer trade in general?

It might be thought that the elimination of trade barriers between contiguous countries would be especially advantageous. This is, however, by no means necessarily so. If transport costs were always especially low between countries belonging to a geographic region, there would be some foundation for that belief. But, in the first place, transport costs are determined not only by distance. Because of the low ocean-shipping costs, countries lying in different continents but on the ocean are frequently closer to one another from the point of view of transport facilities than each of them is to landlocked countries in the same continent or region.

In the second place, low transportation cost is not the only factor determining the economic benefit derivable from unimpeded international trade between two countries. Another factor which is at least as important is the extent of differences in cost of production due to different climate, soil, abilities of the population, natural resources, and other factors. To give a much-quoted example, trade between the United States and the tropical countries of Latin America is more profitable than trade between us and Argentina. The more dissimilar are conditions of production between countries, the more profitable is trade for both of them. Hence a customs union with faraway countries would frequently be more useful than a union with one's neighbors.

NONECONOMIC ARGUMENTS FOR REGIONAL BLOCS

It follows that the case for regional customs blocs as against a general reduction in duties must be based on arguments of political feasibility and military consideration rather than on economic efficiency and advantage. For example, division of labor among distant countries would be fatal in times of war, if these economic ties can be easily severed by the enemy. Moreover it is frequently said that, apart from the hazards in case of war, neighboring coun-

tries that belong to a region or group the members of which are closely related by cultural ties, common history, perhaps linguistic or racial affinity and have similar political systems and traditions are more likely to reach an understanding than countries not belonging to the same region. Also, an agreement reached between such countries is likely to be more lasting than one reached between countries belonging to different regions. Discussion of this thesis in the abstract is not of much use. We had better look around and see whether we can find such regions in the real world.

Let us begin with large areas of continental size. Some reflection will show conclusively that continents cannot be regarded as such regions. There has been much talk about Pan-Europe and Pan-America. Take Pan-Europe first. Where shall we draw the line in the West? Does Great Britain belong to Europe? If she does, then the British Dominions must be included too and also the United States! For the ties—cultural, political, economic —between Great Britain and the Dominions are at least as close as those between her and the continent of Europe. If she is excluded (as she was in most Pan-European utopias before the war[1]) do France and the Low Countries and the Scandinavian countries belong to Europe? Are not the ties between these countries and Great Britain much closer than their ties with eastern Europe? A similar reasoning holds for Italy. Italy and France have very close economic and other relations with Africa and other overseas countries.

At any rate, Pan-Europe is obviously out of the picture for a long time to come. For it is inconceivable that the countries now occupied by the Axis will enter a political scheme which sooner or later would give Germany, their common enemy, a dominant position. Germany can be defeated only with the help of the United States and the British Empire; is it thinkable that France and the Low Countries, Scandinavia, etc., will turn away from their liberators and form a bloc with their former enemies? In the light of these considerations, the whole idea appears utterly unrealistic. Pan-Europe could be created only by the power of Germany against the will of all non-German countries of Europe.

There is no need to show that the same is true of any Pan-Asiatic or eastern Asiatic scheme, with Japan taking the place of Germany.

[1] After the outbreak of the Second World War she was graciously admitted into the Pan-European utopia by its framers.

Also, the Western Hemisphere cannot be said to consist of countries which by their geographies and economic, social, and political relations offer a good chance of being integrated into a Pan-American bloc. Not even from a geographical-locational point of view can the Americas as a whole be regarded as a well-rounded region with clear boundaries all around.[1] It is now common knowledge that the parts of the Western Hemisphere which are in the temperate zone—the United States, Canada, Argentina, Uruguay, and the southern part of Brazil—are on the whole economically competitive rather than complementary as far as their economic structure is concerned. They have large surpluses of the same commodities (*e.g.*, wheat), for which they can find a market only outside the Western Hemisphere. That does not mean, of course, that a fruitful exchange of goods between these countries is not possible, that this exchange cannot be profitably intensified, and that, in the worst case, if the Western Hemisphere had to face a hostile Axis-dominated world (and if certain American countries did not choose, in such a case, to cooperate with the Axis!), a more complete integration could not be achieved. But that is true of any two countries anywhere in the world, practically without exception, and such a complete integration would be possible only at the price of major reconstructions of the economies concerned, implying a tremendous reshuffling of production and productive resources within each country. In fact, we find that "Western solidarity" increases in times of emergency (such as during the First and Second World War), and that it ebbs quickly after the emergency is over.[2]

Let us now look for smaller groups and see whether we can discover regions that are predestined to form an economic bloc. The cases most frequently mentioned are the Scandinavian countries, Belgium and Holland, the Danubian countries, and the Balkans.

The Scandinavian countries are certainly closely related by language, similarity of social organization, political outlook, etc. Economically, however, they do not fit together well. Not much could be gained by combining them in one customs union. Only

[1] For a good discussion of the whole problem from a geopolitical point of view, see N. Y. Spykman, *America's Strategy in World Politics. The United States and the Balance of Power* (New York, 1942), especially Chs. 9, 11, 12, 13. The political aspects have been excellently discussed by Eric Hula in *Problems of Post-war Reconstruction* (ed. by H. P. Jordan, Washington, 1942).

[2] See Spykman and Hula, *op. cit.*

from the military point of view, as a safeguard against aggression, could a union between them have some value. Similar arguments hold for Belgium and Holland.[1]

The region, *par excellence*, which was discussed most during the interwar period is the Danubian basin and eastern Europe. It was the politically and economically weakest spot of Europe. In that region a large economic unit, the Austro-Hungarian monarchy, had been dismembered by the Parisian peace treaties. The frontiers were unsettled and not generally accepted, partly because they were new and partly because they simply could not be drawn so as to separate distinctly the various nations, *i.e.*, in this case, language groups.

It became customary to see a cure for the economic ills from which these countries were suffering in a closer economic cooperation, a customs union, or a substantial preferential customs regime. Undoubtedly, the creation of a larger free trade area would have benefited all these countries very much. Actually, however, developments were in the opposite direction. Each country raised its tariff wall continuously, and the economic ties between the members of the group became weaker as time went on. Many new industries were nurtured behind high duties; and, in 1938, the creation of a customs union would have constituted a major operation on the body economic of the countries concerned. (To what extent the economies of these countries have been integrated with one another and with Germany under the Nazi occupation, we do not know.)

Nobody can foresee what the situation will be when the Second World War comes to a victorious end. Is it possible that the nations in eastern Europe will bury their nationalism and create a big state east of Germany? The Polish and Czechoslovakian governments in exile have reached an agreement to that effect and have declared that they will be ready to invite other countries to join them. The history of the last 50 years, and especially of the interwar period, justifies some skepticism with respect to such declarations. But the terrible experience of Nazi occupation through which these countries have gone in recent years may bring about a profound change in attitude, although nobody can tell for certain whether that will be so or not. But a few things seem to

[1] These two countries actually tried to form a customs union in the period following the First World War. Their plan, however, was frustrated by the British insistence on the most-favored-nation rights.

be clear: there will be great chaos when the Nazi regime cracks, and it will almost certainly be necessary for Great Britain and the United States to occupy Germany, central Europe, and a part of eastern Europe (if these regions are not occupied by Russia). This will offer a rare opportunity to change the organization of these regions in any way that seems desirable, *e.g.*, to unify these countries. If this opportunity for a radical reconstruction is lost and the various countries are allowed to rebuild their economies independently of one another, a reconstruction or unification will be much harder, or even impossible, to achieve later on. What the long-run chances would be for the survival of such a large federation, comprising, say, Poland, Czechoslovakia, Austria, Hungary, and possibly other countries, nobody can tell. It is, however, quite possible that when the memory of the Nazi occupation fades and the German people draw away from aggressive nationalistic ideologies and adopt a more pacifist attitude, centrifugal nationalist movements will again make their appearance as they did under the comparatively liberal regime of the old Austrian monarchy. If that development is anticipated, it would be preferable not to insist on too close integration; it might be better to set up a loose federation that would give rise to less friction between the different nations than a unified and centralized type of organization.[1] But in any case, whatever the type of federation adopted, these countries will need guidance and economic help immediately after the war (relief, then capital, finally markets) from the Western powers or from the League of Nations (or whatever the international organization, which the victors will probably set up, may be called). If this leadership and economic help and cooperation from the Western powers is forthcoming, if a strong international organization is set up, with the backing of the victorious power, and if political and military security is thus secured, Europe gradually pacified, and the burden of military expenditure reduced, the countries of central and eastern Europe should be able to live on a tolerable standard, even without a customs union or a preferential tariff regime. It would be quite sufficient, if excessive protectionism were avoided.[1]

The advocates of regional superstates will say that the economic and political nationalism will flare up again, unless it is checked and held in leash by the formation of a regional federation. This raises a big sociopsychological problem that far transcends the question of regionalism and recurs with the same acuteness in the case of

[1] *Cf.* the views of Prof. Simons in this volume.—Editor.

larger federations which are not restricted to certain regions. The problem is this: which has to come first, the setting up of international organization and machinery or a change in spirit? To put the question slightly differently: is there any use in setting up international machinery like the League of Nations unless the majority of its members are in a conciliatory, cooperative, peaceful mood? Will the creation of an international organization help to promote such a spirit, even if it did not exist in the first place? "Organizational pacifists" take the latter position. They think that the mere existence of "machinery" or "organization" will force a change in attitude. If the representatives of different countries are forced, by the existence of an international organization, to sit down at regular intervals around a conference table to discuss their problems, they will learn to understand one another and one another's problems and will adopt a more conciliatory attitude. The "realist"[1] criticizes this view as facile optimism. He thinks that the setting up of international machinery is useless unless the proper spirit prevails and proper policies are adopted; he even believes that the existence of an international organization like the League of Nations with its large conferences and opportunities for resounding but empty speeches may be positively harmful. It may hide existing cleavages, spell an atmosphere of false security, and thereby prevent or postpone the solution of pressing problems. Or the argument may be advanced that the premature creation of an international organization, even if it does not actually make matters worse than they are, is unwise because it may compromise the idea of an international organization for a long time to come. For example, the League of Nations as an international institution has been saddled with failures and mistakes for which influential member states of the League and their leading statesmen should have been blamed.

The truth is probably somewhere in the middle. There has certainly been an overemphasis on matters of organizational detail among internationally minded people.[2] What has been said

[1] See, *e.g.*, E. H. Carr, *The Twenty Years' Crisis* (London, 1940).

[2] In many quarters the distinction between "federation" and "confederation" is now being stressed. Confederation is a union of sovereign states. A federation or federal union is a type of international organization whereby the individual states give up their sovereignty in certain respects and confer it upon the union. The subjects of the union are thus individuals and not governments or states. The literature on the subject (*e.g.*, the literature emanating from the *Union Now* movement organized by C. Streit in this country) seems to

recently of a good peace, that it was not a single event, but a continual process, holds here. More important than the creation of machinery and even the delegation of power to the international organization is the content of policies pursued by means of that machinery and the spirit in which the power is used.

But, on the other hand, there must be some international machinery and organization. Economic relations between countries are getting too complicated to be satisfactorily settled and arranged by informal agreements and irregular, casual conferences. The liberal methods of general and automatic settlements by means of the most-favored-nation principle and the adherence to certain simple rules of monetary management (adopting a common monetary standard) have broken down and given way to chaotic conditions. It seems almost impossible to revert to an automatic, more or less unconscious process after it has once been called in question and destroyed. As F. H. Knight once said (speaking of the breakdown of the system of democratic government by discussion), "The first aspect of the practical situation resulting [from such a breakdown] is the impossibility of going back to an unconscious or traditional process. There is no way in which a thinking process, once set going, can 'turn itself off.'"[1] The alternative to an automatic liberal system is conscious international agreement which makes a permanent international organization and machinery necessary. But one of the theses of the present essay is that it is better to build on a truly international[2] rather than on a regional basis.

SOME INTERNATIONAL IMPLICATIONS OF ECONOMIC PLANNING

So far we have discussed the problem of regionalism exclusively in terms of tariffs. This limitation can be justified only under one of two conditions: *either* that sufficiently liberal policies prevail in most countries to make it unnecessary to come to an explicit international understanding on many questions other than tariffs *or* that, in the absence of such liberal policies, an explicit under-

be too much under the influence of words and legal distinctions. It overemphasizes technical questions of organization and machinery.

[1] "Economic Theory and Nationalism," Part III, Section 1, "Possible Alternatives to Liberalism," in *The Ethics of Competition* (New York, 1935), p. 318.

[2] This, of course, does not mean that in order for an international league or federation to function with tolerable smoothness all countries of our globe without exception must join it and that all necessary concessions should be made to induce literally everyone to participate.

standing is reached concerning other factors and measures that would nullify the effects on international trade of any agreement on tariffs.

In this section a few words will be added on how our problem —regionalism—would be changed if interventionism and central government planning in most countries were on such a large scale as to make pure tariff agreements between countries worthless. Furthermore, some indications will be given of the degree and types of nontariff intervention that would seriously upset the conclusions reached earlier in this essay.

Suppose a large part of control and planning, which was adopted before and during the present war, is retained after the war, not only controls of international trade, such as export and import quotas, licenses and monopolies, exchange control, etc., but also internal controls of investment, prices, raw-material production, agricultural marketing schemes, and the like. It would still be theoretically conceivable—and, of course, economically desirable—to operate all these controls in such a manner as to utilize as fully as possible opportunities of increasing output through international trade and division of labor.[1] This would necessitate, however, an explicit agreement on many or all of the policies and types of controls mentioned above. Wholesale adjustments in these matters through the automatic working of the most-favored-nation clause, as under the comparatively liberal tariff system, would be impossible. Moreover, it is fairly obvious that what would be required is not an agreement once for all, or for a long time, but continual mutual adjustments. International negotiations on economic matters between all countries concerned would have to go on almost without interruption.[2]

It is virtually certain that it would be impossible to handle the same volume of international trade and to maintain the same degree of international division of labor under the interventionist system of a planned economy as under a system of liberal trading

[1] We are not going into the question here of whether it would be possible at all under such a setup to resist successfully protectionist demands. In other words, we assume—although it may be rather unrealistic—that the various controls are operated with the sole purpose of maximizing and stabilizing output (within the limits set by considerations of external security) and are not misused for the benefit of particular groups.

[2] Between countries with full-fledged quota and exchange control systems, this state of affairs already existed for several years before the outbreak of the present war.

methods. This is true even if we assume—unrealistically—that the strong temptation to misuse the various controls for purely protectionist ends can be successfully resisted.

The implication of this situation for our problem is obvious: the economic handicap of small countries increases sharply under the full-fledged interventionist economic order. It becomes harder or impossible to mitigate it by multilateral trading methods. In addition to this, under a strongly interventionist economic system, opportunities for utilizing international trade and its regulations for purposes of economic exploitation of weaker countries, power politics, and outright agression and subjugation become infinitely more numerous than under the comparatively liberal tariff system. Hence the economic case for bilateral or regional mergers and consolidations of countries, *i.e.*, for the formation of larger economic units, becomes much stronger. In other words, under socialism or highly developed interventionism,[1] the benefits of international division of labor can be obtained on a large scale only at the price of complete economic unification. Moreover, the setting up of consistent production plans and their continual mutual adjustment will certainly require complete political unification.

Whether such consolidations can be achieved peacefully by voluntary agreement is open to serious doubts. The prewar attitude of the then existing states in all parts of the world would have seemed to exclude this possibility. Whether a sufficiently profound and lasting change of heart has occurred, at least in those parts of the world which were ploughed under by the steam roller of totalitarian agression, occupation, and war, remains to be seen.

The alternative to rigid central planning is not, to repeat, an uncompromising laissez-faire policy. That would be hopelessly utopian—and not only because of the wickedness and stupidity of men! What is needed and what to the present writer does not seem to be an entirely hopeless task (although this point cannot be argued here) is the development of an economic system which preserves the essentials of free enterprise, free markets, the freedom of consumers' choice, and the freedom of choosing and changing the kind and place of occupation and which at the same time eliminates or at least sufficiently alleviates the grosser evils of a completely free system. It is impossible to discuss at this point the

[1] Whether and where to draw the line between these two systems and between both of them and capitalism need not be discussed here. See below for a few more remarks.

nature of these evils as the writer sees them and the possibilities of curing them without destroying the free-enterprise system and eliminating the freedom of consumers' choice.[1] Suffice it to say that the greatest economic evil and problem of modern capitalism is not so much inequality but the business cycle, *i.e.*, the fact that our economy is subject to cyclical depressions and periods of chronic stagnation, characterized by unemployment, misery, and falling real income. If it were possible to maintain reasonably full employment in the leading countries by appropriate policies and to assure a fairly steady rise in the standard of living through the smooth assimilation of the benefits derivable from technological progress, a major contribution would be made to the solution of the problem of international economic relations. Professor Hansen, especially, has repeatedly emphasized in recent years that the solution of the domestic employment problem in the leading economic countries, especially the United States, is a necessary (but of course not a sufficient) condition for a successful policy of expanding international trade and international division of labor.[2] In depression periods, when unemployment rises, sales shrink, and output falls, the demand for protection of the home market from foreign competition becomes irresistible. Every increase in imports seems to (and in the short run in most cases actually does) create more unemployment, and every reduction in imports through tariffs seems to add to home production and to augment employment. On the other hand, in periods of prosperity, when labor and materials are scarce and orders in most industries exceed productive capacity, imports rise automatically and the reduction of impediments to imports is accepted with greater equanimity. (At present, for example, imports could be raised enormously and many duties could be reduced or abolished with ease, if the goods could be obtained and transported.)

CONCLUSION

Our conclusion then, is, this: if fairly prosperous (full-employment) conditions in the leading countries could be maintained, it would not be hopeless to revert to liberal policies in the field of international economic relations, abolish quotas, restore stability

[1] A brief statement with which the writer would largely agree will be found, for example, in a paper by F. H. Knight, "The War and the Crisis of Individualism," in *Economic Problems of War and Its Aftermath* (Chicago, 1942).

[2] *Cf.* Prof. Ellis's essay.—Editor.

and freedom in the foreign exchange markets, reduce tariffs, and eliminate discrimination. This is the policy which was promised in the Atlantic Charter, in the mutual-aid agreement between the United States and Great Britain of February, 1942, and which was on several occasions eloquently proclaimed by Cordell Hull and Sumner Welles. In a world organized along such lines, the merger of small countries (complete customs unions) would still be desirable from the economic standpoint and perhaps also from the point of view of preserving peace, if it could be achieved by the free will of the partners; but the creation of such regional units would not constitute an indispensable condition for the preservation of economic prosperity. Moreover, incomplete mergers (regimes of preferential duties in contradistinction to free customs unions) are decidedly undesirable, both from a selfish economic point of view of the countries concerned and because they contain a serious threat of discrimination.

CHAPTER XX

REMOVAL OF RESTRICTIONS ON TRADE AND CAPITAL

HOWARD S. ELLIS

INTERFERENCE VERSUS CONTROL

International trade and finance after the war, it is sometimes thought, either will go the way of the thirties, marked by rigid national interferences of an autarchic nature, or will return to the relatively unregulated character of trade in the prosperous twenties. These extremes—intensive national regulation versus "free" international trade—may appear to be the natural alternatives; in fact, however, they are not the alternatives in prospect. The international movement of commodities and funds will be regulated in all events, and the only issue is, will the regulation be national or international? For now, more generally than before, "governments have definitely accepted welfare economics as a basic policy";[1] and it is altogether unlikely that any nation will again leave to the vagaries of unregulated international competition the crucial matter of total effective demand for its products and its man power. If the regulation is national or even if it emanates from blocs of nations set against other blocs, it will most certainly revert to the types of restriction ushered in by the world financial crisis of 1931—exchange control, quotas, import and export prohibitions, and other beggar-my-neighbor devices. If the regulation is international, these trammeling *interferences* will fall into desuetude; and, under attainable standards of economic intelligence, the international *control* can supply the conditions necessary to vast economic progress.

Which route shall we travel? Looking toward official declarations of policy, we find the Atlantic Charter in points 4 and 5 promising access on equal terms to the trade and raw materials of the world and international collaboration for improved labor standards, economic adjustment, and social security; the Anglo-

[1] J. P. Young, "Problems of International Policy for the United States," *American Economic Review*, Vol. 32, No. 1 (March, 1942), p. 185.

American agreement of Feb. 23, 1942, contemplated "the reduction of tariffs and other trade barriers," although Clause IV makes this "subject to existing obligations." Meanwhile, however, the most important organs of business in Great Britain, while calling for international cooperation, proceed to the advocacy of measures directly antagonistic to this end: the Federation of British Industries to a system of bilateral trade and the Association of British Chambers of Commerce to the complete organization and control of foreign trade on trade association lines.[1] In our own country, Vice-president Wallace's plan for the application of the "ever-normal-granary" principle to a large number of commodities on a worldwide basis parallels the conceptions of British industrialists.[2] Official spokesmen of the Axis powers, Herr Funk, the German Minister of Economics, and M. Riccardi, Italian Minister for Foreign Trade and Exchange, descant upon European cooperation "to bring the nations' standard of living up to the highest possible level," upon the "reduction of economic regulations and coercive measures," and upon the "creation of multilateral agreements"; but "free trade should be considered definitely abolished," and "balanced trade will be increased . . . to eliminate as far as possible the ebb and flow of free exchange and gold."[3]

Whether the postwar period will witness the regulation of foreign trade and finance by nations along traditional lines of protection to particular producer interests, or whether the interest of the common man as producer and consumer—employment and a high standard of living—will form the goal of international controls, this we cannot predict. There are those who confidently look forward to the latter.

If you hold your ear close to the ground, you can hear a muffled roar echoing around the whole world. It does not come from bombs, or thunder on the Russian front. It is the voice of the people demanding security and an end to the paradox of plenty. It is the revolt of the masses asking for the food which farmers let rot upon the ground or dump into the streams. This subterranean roar is the most powerful force in the world today. Statesmen who listen to it will be upheld. Statesmen who shut

[1] "Restraint of Trade," *The Economist* (London), Vol. 142, No. 5154 (June 6, 1942), p. 781.

[2] M. S. Stewart, "Headaches in Post-war Planning," *The Nation*, Vol. 152, No. 12 (Mar. 21, 1942), p. 337.

[3] Geneva Research Centre, *Official Statements of War and Peace Aims* (Geneva, Switzerland, December, 1940, and September, 1941), Vol. I, p. 30, and Vol. II, pp. 1, 5, 11, 12, 13.

their ears will be buried, no matter how lofty their sentiments about freedom and initiative.[1]

Or more briefly, in the words of the *Economist*, "Food comes before farmers."[2] There can be no doubt that this principle, championed by Adam Smith a century and three-quarters ago,[3] will be bitterly contested; should it prevail, innocent as well as guileful beneficiaries of the protective system will suffer.

RELIANCE UPON UNITED STATES' POSTWAR LENDING

Is there not an easier way to the revival of world trade than an uphill struggle against bilateralism, national exchange controls, quotas, and high protective tariffs? Professor Hansen and his followers would rely chiefly upon an "expansionist program" at home coupled with extensive foreign investments by the United States. Proponents of this policy concede that: "It would be as fatal during peace as it would now be during war to revert to thinking in terms of dominant and dependent powers, of competing currency blocs, of discriminatory trade practices, or of restriction of output at the expense of human morale or well-being."[4] But thinking about international security in terms of "tariffs and currencies, . . . cartels, competition, non-discriminatory trade, foreign-exchange control," and the like, is "wholly inadequate," compared to the "more fundamental tasks" of a "positive expansionist program."[5]

Any constructive plan of economic rehabilitation must include large capital exports by the United States, and it will be gratifying if the weight of Prof. Hansen's authority and the influence of his followers secure the adoption of this policy together with the international collaboration it presupposes. If an immense postwar boom is permitted to develop, it may be politically or economically difficult to cope with a tendency toward recession and an excess of saving over investment. In this situation especially, the foreign investment of otherwise idle funds will bless taker and giver alike.

[1] Stuart Chase, *The Road We Are Travelling* (New York, 1942), pp. 83–84.

[2] "Post-war Agriculture," *The Economist* (London), Vol. 141, No. 5127 (Nov. 29, 1941), p. 645.

[3] Stuart Chase, however, mentions Adam Smith only (pp. 32, 51, 97) as an apostle of antiquated ideas.

[4] National Planning Association, *Britain's Trade in the Post-war World* (Washington, 1941), p. 4.

[5] Alvin H. Hansen and C. P. Kindleberger, "The Economic Tasks of the Post-war World," *Foreign Affairs*, Vol. 20, No. 3 (April, 1942), pp. 467–469.

Aside, however, from the circumstance of cyclical depression, capital exports by the United States would play an important and salutary role. If the hand of government, either national or international, is to be felt in economic intercourse between countries, as most certainly will be the case, the regulation of capital flows interferes with private initiative and "individual" enterprise to a much smaller degree than does the regulation of commodity trade.[1] The position can be taken, and is indeed defended in these pages, that the control of international capital movements offers one of the main opportunities for combining freedom and order in international economic relations. The guaranty and placement of foreign loans by the United States or a government corporation will achieve more toward domestic employment and standards of living than interferences with commodity trade, such as bilateral clearing, with its inevitable losses in particular lines at home and abroad and its lowering of the general level of efficiency.

Emphasis should be put also upon the revivifying effect upon foreign *commerce* in the immediate postwar scene produced by the transfer of the *principal* of the loans. However great the eventual marginal efficiency of the transferred capital may be in the receiving economies, the principal will amount to several multiples of the annual product. Thus the strongest stimulus to trade comes at a time when it is most needed, both from the angle of physical and economic wants and from the angle of morale. Finally, there is good reason for believing that an extensive outflow of capital from the United States would be in the direction of increased long-run productivity for the lending economy, an assumption which rather clearly underlies Prof. Hansen's argument.[2] If so, an old frontier of investment has been rediscovered.

Despite the unquestionable merits of the lending program, it is very doubtful whether this is really the "fundamental" task, whether indeed it is not decidedly less important than the removal of restrictions on trade and capital, characterized by Prof. Hansen

[1] From the angle of the cost and utility calculus, the stoppage of a million dollars of capital movement entails, under ordinary conditions of trade, a smaller economic loss than the stoppage of an equal movement of any specific commodity. Furthermore, the *morale* of private enterprise is more seriously impaired by the latter sort of interference. The same conclusions hold if we are thinking, not of reducing a movement below its "natural" potential magnitude, but of forcing it above that level.

[2] Hansen and Kindleberger, *op. cit.*, *passim*, and especially p. 474, end of Sec. III.

as "wholly inadequate." "The first step," declares the author of *Britain's Trade* (p. 31), "is to render the world prosperous." This is a brave sentiment. But is it not worth inquiring whether the government of the United States can command resources sufficient for this "first step," and whether this is in reality the *first* step?

If the American economy can contribute 50 to 60 per cent of the national income for war, it is no doubt both "physically" and "economically" possible to make a contribution of comparable magnitude for the guaranty of international security by peaceful means. Politically or psychologically, however, the matter would assume quite another aspect; and the "several billion" mentioned by Prof. Hansen[1] probably connotes to him also much smaller sums. Our largest net balance of foreign lending, which occurred in 1919, amounted to somewhat over $3 billion. In 1927, a year of rather general peacetime prosperity, creditor countries in the aggregate lent $2.25 billion net.[2] Richard M. Bissell, in over-all estimates of American postwar expenditures, assigns to foreign lending a sum of $1.5 billion, but as "the lowest figure that is at all realistic."[3]

Suppose we think provisionally in terms of United States loans somewhere in the region of $3 billion annually. In 1938, the last year before wartime controls of trade, world exports amounted to $13.3 billion and world imports to $14.2 billion.[4] If after the war trade is resumed upon a comparable scale, the transfer of $3 billion annually would mean a very substantial increment to *international trade*, as was emphasized a moment ago. But even a large increase of foreign commerce is a far cry from rendering the world prosperous. For prosperity indicates, and undoubtedly Prof. Hansen means, an approach to full employment in the *domestic economies* of the nations; and there, in contrast to international trade, $3 billion would dwindle to relative insignificance. Federal net contributions to national expenditures of about this size during our domestic spending program failed to prime the economic pump of this one country; the expenditure of $3 billion, or even substantially more, diffused through the world, without a drastic

[1] *Ibid.*, p. 466.

[2] This figure, in predevaluation United States dollars, is given in a computation covering 1927–1937 by Colin Clark, *The Conditions of Economic Progress* (London, 1940), p. 463.

[3] Richard M. Bissell, Jr., "The Anatomy of Public Spending," Part II, *Fortune*, Vol. 25, No. 6 (June, 1942), p. 132.

[4] League of Nations, *Statistical Yearbook*, 1940–1941 (Geneva, 1941), p. 177.

change in underlying conditions, would meet the same fate. International commerce would be sustained, as was our domestic trade, only so long as the transfer of new loans continued.

The raising of $3 billion annually for foreign investment, and *pro tanto* for larger amounts, might encounter difficulties, whether the process involved direct government loans or merely government guaranties. If our own economy were approaching full employment, it is quite conceivable at the termination of a long war that capital should be relatively scarce and interest rates threatening to rise, with unwelcome consequences for government bonds and banking and insurance companies. Public sentiment in these circumstances—which include also a public debt of unprecedented size—might be intolerant of the loan program, particularly if the bottlenecks of this new prosperity were less labor of particular sorts than capital for reconverting plant, introducing new processes and products, and making good upon wartime depreciation, all of which some economists believe may involve very large outlays.[1] Public sentiment might be the intractable element also in the contrasting situation of a postwar slump, when a perverse but highly probable mass psychology, heedless of the possibly beneficent operation of the foreign-trade multiplier, would rebel against foreign loans when the money, following the advice of the expansionists, could have been used for domestic public works, relief, or subsidies to private industries. Finally, if the program of foreign investment were to be provided out of Federal deficit financing, we would encounter in augmented degree the popular misgivings about increasing indebtedness.[2]

The resistance of public opinion, however, whether in a setting of prosperity or depression, is not evidence *against* a program of foreign lending any more than it is an argument against a policy of removing the prevailing obstacles to trade, which would also encounter formidable opposition in quite vocal quarters. Strategically, the position of the latter program for the United States has in its favor the fact that bilateral payment arrangements, quotas, direct prohibitions, and discriminatory practices have prevailed only during the war period, and probably have not, except for protective tariffs, come to be regarded as a part of the American

[1] *Cf.* Bissell, *op. cit.* (also Bissell's essay in this volume.—Editor).

[2] "Our own view is that the success or failure of public works and budget deficits during a depression will depend largely on whether the public in general, and investors in particular, approve of these policies." Frederic Benham, *Great Britain under Protection* (New York, 1941), p. 236.

way. The point concerning public opinion is not, on the other hand, its more favorable aspect for the reduction of restrictive devices, but the limits it may impose on resources available for foreign loans. Need it also be said that public opinion on this head may not be without substantial foundation in facts? These limits warn against too optimistic expectations of "making the world prosperous" through a flood of investment capital pouring out from America.[1]

Let us look aside from these limits and imagine capital exports by the United States of magnitudes so great—probably several multiples of $3 billion annually—that not only is international trade increased through the transfer process but also the capital equipment of foreign economies is raised substantially. Would this bring universal prosperity? Was it through inadequate capital equipment in European and other economies that the depression of the thirties deepened into something thought to be secular stagnation? Had New Deal policy also included the making of extensive loans abroad, is it at all imaginable that it would have broken the mainspring of Empire preferences, of German bilateralism and discriminatory trade, of the French quota system? Without some sort of political accord leading to economic and monetary collaboration and direct procedure against these practices, nothing more than transitory alleviation would have resulted. Nothing more could be expected in the postwar scene.

Without some form of international economic authority and control, itself powerful enough to cope with threatened restrictions on capital and commodity movements, there is little likelihood that foreign loans of any significance will be made by this or any other country. Neither the government nor private investors will be disposed to the "reconstruction of Danubian agriculture" if this region is again open to a German trade drive with the weapons of economic discrimination, nor to "the control of the flood of the Yellow River" if Japan can conduct economic warfare on its neighbors. Aggression is not the only peril: what becomes of creditors' claims when a country attacks its own domestic unemployment by means of import duties, quotas, and prohibitions, or by exchange control and frozen accounts? Extraterritoriality is probably at an end, and it is even doubtful whether countries poor in capital could be induced to borrow without international guaranties against a repetition of the capital withdrawals following

[1] *Cf.* the views of Mr. Bryce in this volume.—Editor.

1931. Finally, without international guaranties against economic warfare, Russia can scarcely be expected to acquiesce in the extension of American financial capitalism through enormous foreign investments.

In short, instead of being less fundamental than the "positive expansionist program," the removal of restrictions on trade and capital completely conditions both its existence and its success. The former is the *sine qua non* of the latter, not reciprocally, however desirable the loan program per se. "There will be substantial and fruitful movements of capital only if a peaceful, orderly world is restored, if nations find their balance, both inside themselves and between themselves," writes Herbert Feis.[1] And, he continues, in a world brightened by freedom of trade and finance, international capital movements can be expected upon an unprecedented scale. Measures to restore that freedom can be regarded as passive only if investment has inherently a tendency toward stagnation. But it may well be discovered that stagnation inheres only in the obstacles to spontaneous economic intercourse.

INTERNATIONAL MONETARY CONTROL

The indispensable and adequate *positive control* which must be exercised *over* national governments in economic matters to preserve equilibrium and reasonably full employment of resources is best described as "monetary" control. The reasons for this will be set forth shortly; but first we must consider the necessary conditions for removing the obstacles to international trade and finance. This is primarily not an economic but a political problem. But the economist must envisage the most probable political settings in order to frame his analysis. If the war ends with the Axis powers either victorious or undefeated, there will be no prospect for the removal of existing complete authoritarian control of foreign trade along strictly national lines. Bilateralism, exchange control, and other weapons of economic warfare are a part of the Fascist-Nazi arsenal, and they can be met only with the same devices. If the war ends with victory for the United Nations, the decisive issue will be the prestige and attitude of Russia. If Russia holds a position of great power and will have no truck with "capitalism," the Western countries will again have to retain import and export controls practically upon the existing basis. If the United States

[1] Herbert Feis, "Foreign Investment in a Post-war World," *Fortune*, Vol. 26, No. 1 (July, 1942), p. 116.

with Great Britain holds the reins, or if Russia is inclined by interest or political philosophy to collaborate in a liberal international economic regime, the regulation can be transferred from nations and blocs to some *joint authority;* in this event, as the first paragraphs of the present analysis indicated, the regulation can be transformed from interference to control. Those who believe that we fight for the outlawing of military aggression will expect this "joint authority" to rest, not upon mere "cooperation," which is limited by the self-interest of a particular state, but upon genuinely sovereign power including force of arms.[1]

Only the victors can introduce freedom of trade, and being victors they would be able to impose it upon the vanquished. The victors may hesitate because of vested interests, "depressed areas," and pressures within. However, in Great Britain protection to domestic industry is only a decade old, it is restricted to fabricated goods, and the rates of duty are relatively moderate. Furthermore, imperial preference has been reported to be losing favor, in both England and the colonies.[2] Bilateralism was for the most part induced by the freezing of England's accounts abroad, though the case of Argentina is an important exception; and the quota system before the war was not extensive. Finally, except for the war, England has not adopted exchange control. For these reasons, England may show less resistance to reform than the United States. Here, it is true, bilateralism, exchange controls, quotas, and the like, are not apt to enjoy much favor; but protective tariffs in the United States, particularly on certain agricultural raw materials, promise to be the one most formidable obstacle to postwar international reconstruction. If the state must aid particular segments of the economy, it may perhaps be recognized, however, that direct subsidy is much less costly and destructive than protectionist devices.

Assuming the will to remove these obstacles, the *modus operandi* is to remove them. Capital movements will have, it is true, to be governed, in both negative and positive senses. But for the trade in goods and services, action must be prompt and drastic. The immediate postwar period, as John Parke Young maintains,

[1] Eduard Beneš, "The Organization of Post-war Europe," *Foreign Affairs*, Vol. 20, No. 2 (January, 1942), pp. 240–242; John Foster Dulles, comment upon "The United States in a New World," supplement to *Fortune*, Vol. 25, No. 5 (May, 1942), p. 28; Prime Minister Menzies, *The Times* (London), Oct. 18, 1939, p. 7.

[2] Benham, *op. cit.*, Chs. II, IV.

"will be a time of flux and shifting within industry, a period of extensive adjustment to new conditions. At such a time sharp reductions in certain rates could be made with the least harm and opposition."[1] Still better, perhaps, is Buell's proposal that "the United States and the United Kingdom should declare that any restrictions on their own trade would come to an end, say, within six months from now." When trading relations are reestablished, exchange would proceed "without hindrance of tariff, license, quota, exchange control, or subsidy."[2] Only thus can the economic readjustments after the war be made to serve the purposes of international exchange, instead of perpetuating old barriers or creating new ones.

This is particularly true of Great Britain; and those who would aid her by a continuance of bilateralism actually jeopardize her welfare. Her salvation rests upon "adapting British productive skills to the requirements of the world market," not only ultimately, as admitted by those condoning a transitional bilateralism,[3] but *pro tanto* immediately after the war. With her peculiar dependence upon a flourishing state of world commerce, England can ill afford any provocative beggar-my-neighbor devices. The most substantial aid, beyond the program for liberating trade from national restrictions, would be the extension of long-term loans for the reconstruction, rationalizing, and redirection of her industries and the replacement of lost shipping.

International monetary control in active and positive roles could, and indeed "must," follow the liberation of trade from restrictive and discriminatory devices. Since real *control* is unimaginable without an international sovereign power, it would be anomalous if the monetary authority were not a part of this power. An international banking consortium, a congress of central banks, or an international Reconstruction Finance Corporation, would be a half loaf better than none and might be successful in implementing the very desirable program of foreign investment which Prof. Hansen envisages for the United States. But the organ charged with this responsibility almost automatically inherits responsibility for exchange rates (their stabilization and occasional adjustment), for

[1] Young, *op. cit.*, p. 189.

[2] Raymond L. Buell, "Relations with Britain," supplement to *Fortune*, Vol. 25, No. 5 (May, 1942), p. 14.

[3] Hansen and Kindleberger, *op. cit.*, p. 471; National Planning Association, *op. cit.*, p. 31.

checking capital flights, for staying the process of recession and liquidation in key economies and its spread to other economies, together with some necessary responsibility for national monetary and fiscal policies when they give rise to international repercussions. Quite clearly, this implies a great deal more than an international loan agency, indeed, it involves nothing short of general economic cooperation and an international economic authority. Furthermore, national economic and political power *necessarily inheres*[1] not only in the magnitude of a country's international trade but also in the division of a country's exports and imports among its trading partners, as a brilliant theoretical and statistical demonstration by Hirschman proves. Indeed, the necessity of a regulating international authority is the logical implication of the current theoretical and "practical" works dealing with recent tendencies in world trade.

And yet "monetary authority" seems to carry about the right implication as to powers already characterized as "indispensable and adequate" to this end. The preceding paragraph has indicated the principal functions of an *indispensable* nature, and these, it will be observed, are largely monetary. In the immediate postwar period, private capital would scarcely brave the risks of overseas investment alone, and it is desirable that the guaranties be international rather than national. Secondly, as Halasi explains,

> Confidence is destroyed if debts are not paid on maturity; and it is destroyed if the relative prices of commodities fluctuate wildly. These two prerequisites mean, if applied to transactions between economic areas, that the balance of indebtedness between them has to be kept liquid, and that their rates of exchange should not change frequently and strongly.[2]

After the experiences of the thirties, it does not seem necessary to press the point that international authority must be invoked to assure the inviolability of creditors' claims. The analogy with domestic loans is perfect: who would lend if creditors had no legal rights? But the analogy extends to the debtor side as well. Nations, like commercial banks, are vulnerable to runs; their only protection is a central institution to provide liquidity to check the flight of capital.

[1] O. A. Hirschman, in a forthcoming work entitled *National Power and the Structure of International Trade.*

[2] Albert Halasi, "International Monetary Cooperation," *Social Research*, Vol. 9, No. 2 (May, 1942), pp. 183–184.

The international monetary control would be too narrowly conceived, however, if its functions were merely episodic; responsibility extends also, perhaps primarily, to cyclical and "structural" changes. To cope with international aspects of the latter, the control must occasionally adjust exchange rates to parities corresponding to equilibrium rates in the new situations. To cope with cyclical variations, it will, in the first place, veto any devaluation below equilibrium designed to expand employment in one country. But, secondly, it will need to exercise continuous control over the volume of purchasing power in the important collaborating countries. This involves powers comparable to those of a strong central bank—but not more—on the side of commercial credit. If control over cyclical expansion and contraction is to be effective, the international instance will also impose outside upper and lower limits to the amount of deficit financing or debt retirement by the Treasury. Together with the imposition of outside limits to commercial bank credit, this power, of which cooperating nations would be most jealous, is veritably the crucial defile of international economic comity. While somewhat less severe than the complete suppression of money creation by members, as for the states in our own country, it secures the essential element of international money. The adoption of this crucial over-all control has not only the great merit of really ensuring international equilibrium but also of relieving the countries of the intrusion of international control into matters of the "social budget" and wages. Such an international control is not without historical precedents, for example, the limitation of credit expansion by the Reichsbank under the Dawes Plan and the League of Nations' oversight of national treasuries and banks in the debtor countries of southeastern Europe.

If these avenues of regulation—it will be observed that they fall under "monetary control," broadly interpreted—are admitted to be necessary, can they also be regarded as *adequate?* This question can be answered, of course, only in an approximate fashion; but, I believe, it can be answered affirmatively. The international controls should be designed to permit the inclusion of "capitalist" and collectivist economies alike; and, although a collectivist economy such as Russia's can survive and even flourish in a liberal international regime, a liberal economy would be next to impossible in a collectivist or totalitarian international order. The monetary controls which have been set forth seem to be at least approximately

adequate to a *liberal* international system. They are a far cry from *laissez faire*, but they would encourage private saving and investment and individual enterprise in the production, export, import, and sale of particular goods.

SPECIAL ASPECTS OF MONETARY CONTROL

International monetary (or economic) cooperation does not involve the invention of some new international money, the rehabilitation of sterling or dollars as a world currency, the creation of a universal multilateral clearing system, or even the restoration of the gold standard. *Any* of these systems could indeed be used, so long as short-term balances (or the money itself) are freely transferable; but *without any* of any—*i.e.*, with nothing but national fiat standards in existence, but with the same stipulation concerning transferability of balances—the international monetary authority could operate quite successfully. Economically, international money is created by the existence of this authority; and the physical, numismatic, and technical character of the medium or mediums of value and exchange are impressively inconsequential. The only serious limitation upon this heartily dogmatic statement arises from the psychological aspects. Thus, a proposal for international currency "backed by gold" might appeal to the popular imagination and lead to a wave of sentiment for an international monetary authority, the powers of which are really the crucial matter. Or a system of "international bookkeeping" might be a catchword; we would have it anyway with a gold standard, fiat currencies, or multilateral clearing. From the psychological angle, in itself very important, probably most can be expected from the reconstruction of the gold standard under international auspices.

Thus the necessities of future economic collaboration have rendered largely otiose the discussion of gold versus free exchanges, and of stabilized versus fluctuating rates. The former is merely technical, given the purposes and powers of the collaborative organ; and the latter is settled by the recognition of the desirability of stability, with provision for adjustment by international authority on rare occasions to meet secular or structural change.[1]

[1] Commenting upon a proposal for an "export currency" apparently made at the Rio de Janeiro conference of foreign ministers by the United States Treasury, Secretary Morgenthau "emphasized that he was not proposing stabilization of currencies domestically, since 'when you try to stabilize a currency within a country, you get into the whole question of its economic well-being.'" *Cf. New York Times*, Jan. 23, 1942, p. 8. Did the Secretary imagine

In contrast with technical payment arrangements, just now discussed, the choice of parities for the resumption of normal trade after the war may be thought to be an especially severe problem. The problem would be impossibly complex, indeed, if it were necessary to rely upon computations of parity from price and wage levels. Both have been controlled, and the addition of rationing and priorities, to say nothing of export and import controls, makes the data of the war period valueless for the restoration of free exchange and free exchange rates. Rates must be allowed to assume their positions freely in answer to supply and demand forces, the only precautions being the rapidity with which frozen funds are made available,[1] and the rate of new lending and borrowing. "Freely" does not, upon a reasonably liberal interpretation, preclude the use of foreign loans or a stabilization fund to prevent an excessive *baisse*, unwarrantable upon somewhat longer run conditions, which would probably attend the removal of commodity controls.

The policy of permitting exchange rate adjustment to prospective long-run equilibrium levels should be followed in the case of Great Britain specifically to cope with the probable "shortage" of dollar exchange. Against this it has been argued that the sterling area and the United States would meet the depreciation of the pound by parallel devaluations; but this is an argument only in the absence of international monetary agreement which would *secure* the fall of sterling relatively to other currencies. Again, it is apparently argued that favorable British terms of trade are necessary as an offset to the loss of her foreign markets, her foreign investments, and her mercantile marine. These circumstances do indeed establish the necessity of postwar economic aid. But it is a *non sequitur* to argue from the necessity of aid to the necessity of a high sterling rate. If in the long run and aside from discriminating prices and rates, the price elasticity of British exports exceeds that of imports—familiar reasoning establishes a fair expectation of precisely these circumstances—the "aid" would take an ironically perverse turn. Furthermore, whatever temporary gain might ensue from an artificially high sterling rate could be equaled mechanically by a loan, with a marked superiority of the latter device in securing an objective price system on commodity markets.

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that an internationally stable currency avoids the issue of domestic stability and well-being?

[1] Judd Polk, "The Future of Frozen Foreign Funds," *American Economic Review*, Vol. 32, No. 2, Part 1 (June, 1942), pp. 260–271.

It is also maintained that a depreciation of sterling would fail to lower the price of British exports because the price of imported raw materials for fabrication and reexport would rise. This overlooks the facts that the margin between import and export prices would necessarily decline and that a fall of this margin, on the presumable long-run import and export price elasticities, would necessarily improve the British balance of payments situation. Finally the inelastic demand for imports into England under war conditions where "price doesn't matter" has been projected indefinitely into the postwar period, when, unless England is permanently to be supported by this country, the price of imports *must* matter. The best answer to the policy of maintaining sterling above its natural equilibrium level appears later in the tract defending[1] the policy. The salvation of the British export industry "must be found in the development of products which that industry can make cheaper and better than the rest of the world"; the alternatives, "exchange control, clearing agreements, and bilateral trade"—which, it may be added, would be necessitated by the overvaluation of sterling, as they were in the case of the mark—"would have consequences for an international economic order of peace and harmony which are terrifying."[2]

The analysis of the preceding pages is based upon two premises: that full employment and high incomes are more likely to be achieved when production is oriented toward maximizing the consumers' position than when it is oriented toward producers' profit margins; and that the maximization of the consumers' position under conditions of peace is more likely to be achieved by an objective price system than by authoritarian price control. In international trade and finance the orientation of policy to producers' profit margins spells protection and restriction; and the fixing of prices at levels incompatible with consumers' choices spells bilateralism, exchange control, and discrimination. The removal of these obstacles to international trade and finance effectively conditions both the appearance and success of extensive foreign investment by the United States. In conjunction, the two programs hold the economic promise of the future: the encouragement of saving, investment, and free enterprise, and the establishment of international economic order.

[1] National Planning Association, *op. cit.*, pp. 24–25.

[2] *Ibid.*, p. 31; *cf.* also p. 29.

Chapter XXI

INTERNATIONAL ASPECTS OF AN INVESTMENT PROGRAM

R. B. Bryce

Under this heading two questions are to be considered: firstly and briefly, certain international effects of a substantial, directed program of domestic investment, and, secondly, the opportunities and need for international investment in a publicly directed program of postwar investment intended to provide full employment and to increase the standard of living of the peoples of the world. Obviously, both of these are large and important questions, on which only a very little can be said in a few thousand words. For most countries of the world, these international aspects of an investment program are the vital ones, and in the light of them the outside world will judge the success of the United States in discharging the historic responsibilities that victory will thrust upon the dominant political and economic power.[1]

I

A program of active domestic investment in any country will have an immediate and substantial effect in increasing the demand for imports. The relative amount of this effect will, of course, depend upon a host of factors, including the nature of the investment and the amount and nature of the increased consumption to which it gives rise, the type of economy in which it occurs, and, particularly, the degree to which that economy is dependent upon imports. If foreign exchange is available, this increased demand for imports will be effective in markets abroad and will result in higher imports. The more that domestic investment programs are being followed in other countries, the more general will be the increased demand for imports and the more readily will foreign exchange be available to each country to make its import demands

[1] It need hardly be stated explicitly that the discussion in this essay is based upon the expectation of an Allied victory. The author desires to emphasize that the opinions expressed or implied here are purely personal.

effective. Fortunately, the United States, whose domestic investment program is most relevant here, is possessed of such vast gold and exchange reserves that there is no need to worry about the possibility of its not being able to make its import demands effective, so it is free to take the initiative. Many other nations, however, particularly after this war, will not have the gold or exchange reserves or other international assets to indulge their higher demands unless and until export markets increase, owing to parallel action in other countries, or to other causes. Indeed, in many countries a domestic investment program, if it is to take a useful form, must itself be contingent upon the exchange being available to purchase the imports of capital goods, and, in the absence of expanded export sales, or loans from abroad, such a program may require a reduction in other types of imports. This consideration indicates the importance of parallel action in following expansionist programs, and of countries such as the United States, which have large exchange reserves, taking the lead in the initiation of expansion.

Substantially increased demands for imports, such as would result from a successful investment program, would be of the utmost importance in international economic affairs. Indeed, it would hardly be an exaggeration to say that a strong and effective demand for imports by the major industrial nations is the key to the solution of most of the very troublesome problems of international trade and finance. Given that demand, nations dependent on exports are not at the mercy of one buyer and have an opportunity to adjust their economy to the production of alternative products, if there is a surplus of one. Given markets, debtor nations can honor their obligations. Exchange rates can be maintained at reasonable levels, and controls can be relaxed. The increase in the imports of the countries carrying on the investment program will enable their suppliers in turn to import more from them, because of higher incomes and a larger volume of available exchange, which of course will add to the original effects of the program upon employment and production.

A high level of employment, production, and import demand will have more lasting institutional effects. It will provide a milieu in which existing impediments to trade can be removed or reduced. Any internal effects of such changes can be more readily absorbed at times of good employment and production, because the economy is more fluid and labor and other resources can be transferred with-

out running the risk of prolonged unemployment. Moreover, vested interests are less likely at such times to get sympathetic political support in opposing changes that would favor international trade.

The favorable effects noted above constitute the methods by which the recovery or prosperity produced by a well-directed investment program is transmitted and shared between nations. It must be realized, however, that these beneficial international results are not obtained without certain immediate effects upon the domestic situation. The nation giving a lead to others will not, during the period of leadership, be receiving as much stimulus from abroad as it is transmitting, and the net increase in its imports over its exports constitutes one of the "leakages" by which the original stimulus of the investment activity is absorbed; *i.e.*, the international effects cut down the domestic "multiplier." They make full employment in one country more difficult to obtain because it is shared to some degree with others. In the long run, however, they make it more effective, because they make possible the advantages of trade, which make it possible to use labor where it is most productive, thereby enabling a higher standard of living to be obtained from a given level of employment. Moreover, they create an international situation in which foreign as well as domestic investment is possible.

For any nation largely dependent upon imports, these considerations are of the highest importance and make it necessary to relate an expansionist domestic program to the situation in the countries with which that nation carries on its most important trade. If such countries take a lead in expansion, they may find their domestic "multiplier" disappointingly low and their exchange reserves depleted. Temporary foreign borrowing, or in its absence, exchange depreciation or control, may be a necessary and possibly quite justifiable price for such a country to pay for initiative and independence in economic policy.

Finally, we must, of course, remember that the physical fruits of a domestic investment program are bound to have international effects. It is difficult to generalize in advance about these, but if the investment is to a large extent in industries likely to displace imports, then the international benefits accruing from the immediate effect of the investment upon incomes and import demands would before long give way to unfavorable international results. On the other hand, investment which has the permanent effect of so adding

to productive power that it raised the general standard of living and therefore the demand for imports would continue to have favorable international repercussions long after the immediate stimulus afforded to purchasing power had passed away.

II

If the type of program contemplated in this book is to be general and most effective, it must involve international investment on a large scale. If our wartime protestations of allied solidarity and of a desire to improve the standard of living of all those who live in want are to be carried out—if indeed in the postwar world we are to apply the lesson the world has now learned at so heavy a price, that no nation can live unto itself alone—then we must have substantial loans from the richer states to the poorer states of the United Nations. If this is to be either the American Century, or the Century of the Common Man, or both, American capital must go abroad to make it so.

These conclusions follow from the fact that most of the world and its inhabitants are woefully short of capital and are unable to provide it from current income at the low levels that must prevail until capital is available to make it more abundant. Modern knowledge and technique, alone, are not enough and indeed cannot be applied without capital. Billions upon billions of dollars must be invested in Asia, Polynesia, South America, and Africa, if the great masses in these lands are to be made productive and eventually brought up to minimum standards of health and decency, let alone comfort. No amount of good will, or even of demand for native products, will substitute for the capital that is necessary to improve production and health.

It is in these backward economic areas that capital in this century can be most productive, in the sense of earning the highest real return in goods and services. For that matter, it should be possible in those areas for capital to earn the highest monetary return as well, if the investor desires to exact all he can from the needy borrower and if the investing nation is prepared to accept directly or indirectly the goods in which such return must eventually be transferred. Indeed, when one bears in mind the appalling shortage of capital and opportunities for investment in so many parts of the world, it is disturbing to see the economists of the United States and Britain racking their brains to cope with the apparent dearth of investment outlets, to devise artificial means

of reducing the propensity to save and of stimulating expenditure, and even at times defending relatively wasteful expenditure or investment. Only if large-scale international investment is out of the question can such efforts be justified.

It is well to recognize at the outset that the benefits of such foreign investment would not be confined to those who live in the borrowing countries. The lending countries will gain immediately in the sense of finding a useful outlet for their employment, production, and savings; and if, over the course of time, they can manage their economic and international affairs sensibly, they will gain in the higher return of real goods made possible by such productive foreign investment and obtained as interest and repayment.

In what form is this international investment required? A proper answer, of course, must require careful, detailed study of the various regions concerned, but from general knowledge of the areas it is not hard to suggest the main lines. If large areas of Asia, South America, and Africa are to be made productive and are to enjoy a little of the benefits of modern science and technique, they will need capital in the first place—and perhaps most significantly—to make their agriculture more productive, for it is on agriculture that most of their people depend. They require great amounts of capital for the roads and railroads that form the essential framework of a modern economy and that are needed to make possible the specialization of land and labor and the interchange of products that is the beginning of efficiency. In many areas, flood control and irrigation works are needed, and these absorb capital in vast quantities. Capital is needed for public health—for water-works, sewage systems, hospitals, and housing. It is needed to build towns and cities. And of course it is needed for commercial and industrial construction and equipment—from retail stores to mines, from utilities to cotton mills. We are too likely to think of capital as being required primarily for industry; we must remember that in these areas as elsewhere greater amounts may have to be invested in other forms than in industry proper, if an efficient economy is to be created. This fact is important in assessing the magnitude of the flow of capital required, as well as the probable nature of the investment mechanism.

China is the outstanding example of the magnitude of the opportunities for investment and of their diversified nature. Here we have the largest nation in the world and the poorest economically, an ally that has suffered longer than any in this war—and

certainly as badly—that is desperately short of capital, with its land deteriorating and its increasing population pressing continually against its means of subsistence. Yet it is a nation with large material and human resources, now keen to take its place among the progressive democracies of the world and to do its share of the work and the trade, thereby to achieve something better in the way of living standards than the dreadful poverty that has been the lot of most of its people. But it obviously cannot save enough out of its meager income—even in times of peace and good trade—to improve its position quickly. Its people have literally starved for the lack of capital for roads and railroads; millions have been drowned and millions more have lost their homes because of lack of flood-control works. If China is to be rehabilitated, improve her agriculture, establish a minimum of transport, industry, and commerce, and, within a few generations, provide the barest needs of public health and education, she will require foreign capital on a scale never witnessed elsewhere in the world. Of course, the world is better able than before to supply capital on the vast scale required, once the war is over.

It must be recognized that more than capital, in the narrow economic sense, will be required in most cases. Technical knowledge and management will be needed, firstly, to carry on the construction work and the creation of new industries (possibly to assist in the improvement of agriculture); secondly, to assist, at least for a time, in the operation of what is created; and, finally, to train and educate those who will ultimately take over the management. It is natural to expect that those, or at least those nations, who furnish the capital will also furnish the technical and managerial skill required to make it effective.

The methods and institutions by which this foreign investment will be made are difficult to anticipate until one has some idea of the political and social circumstances to be expected after the war. From what has been said above, however, it is clear that a considerable part of the funds will be required by public or quasi-public agencies of the borrowing nations—such as capital for roads, flood control, irrigation, public-health projects, and other municipal or local utilities. Possibly capital for agriculture in these regions will also have to pass through some governmental channels if it is to be used in programs of national development and to be available at interest rates within the ability to pay of the farmers who need it most. Capital to provide railways and utilities may be invested

by either private or public agencies, and the choice will probably depend as much on the willingness of investors to risk their capital in foreign rails and utilities (some of which have not had happy histories) as on the political and social complexion of the borrowing country. Commercial and industrial capital seems much more likely to be invested and managed by private organizations, although even in this field the events of recent years in Latin America and the Far East would give some grounds for expecting that nationalist foreign governments will prefer to establish state concerns, particularly for the development of natural resources where the dangers of unreasonable exploitation are greatest. Chinese experience with industrial cooperatives and government trading organizations during the war may lead to vigorous peacetime development of these relatively novel types of organization. Experiments with government-sponsored "mixed" foreign- and domestic-owned corporations in South America may also point toward new forms of international investment more suited to both the economic and the political requirements of the twentieth century than anything common in the past.

There is no fundamental reason why the intervention or use of the government or of quasi-governmental agencies in the borrowing country would necessitate the intervention or use of the government or an official agency in the lending country. In the past, at one time or another, private capital has been borrowed directly by foreign governments or their agencies for almost all conceivable purposes. The history of such foreign investment, however, has been anything but happy in a great many fields. The experience of British and American investors in the government securities of other English-speaking countries has been generally satisfactory and in most cases highly profitable. Nevertheless, in the future, the type of project we are considering is much more likely to be compared with the investments in other areas where the investors' experience with privately sponsored security flotations has been far from satisfactory, particularly in recent decades. Political risks are likely to be considered very serious after the turbulent 30 years we have just been through. Both these and the economic risks of depressions and exchange difficulties will make the private investor and investing institution in North America—and probably Britain, too—hesitant about risking his capital in the development of distant areas unless he is offered some sort of guaranty or until he has had some chance to see the brave new world behave. More-

over, there does not appear to be a sufficient number of established private organizations, in the United States at least, with knowledge of the investment requirements of the Far East and South America and with adequate contacts there to serve as a channel for the very large volume of investment which would be required. Given some assurance of political stability and confidence in economic development, private investors may ultimately be prepared to lend great sums abroad, but we cannot rely upon them in the early stages.

Furthermore, the governments of the borrowing countries and their agencies may be somewhat reluctant to go to private bankers and underwriters for their requirements if there is any chance of obtaining capital from official agencies. Private capital is apt to demand higher interest rates or better security. There is also some chance that borrowing countries may feel a greater danger of imperialist, capitalist influence in their affairs by private investors and bankers than by the government of the lending nation or some agency of it.

These considerations suggest there will be a considerable demand for a public or quasi-public foreign investment agency in the large lending countries, particularly the United States, which will be looked upon as the obvious source of foreign capital. What would be the most effective form of such organization, whether it should be international in its composition, and how it should function, are questions into which we cannot enter at this time. Possibly, some such organization will grow out of wartime or immediate postwar relief organizations.

A government lending agency would have some substantial advantages. It could raise capital very cheaply and in the large amounts required. Therefore, it could more readily lend on terms that were possible of fulfillment. It would be better able to provide for flexible terms of repayment over a long period, integrated with the trade and monetary policies of the creditor nation. It could take into account as gains the many indirect benefits to the lending country of the investment program, the stimulus given to employment, and the improvement of international relations and security. If, as one might hope, there are to be genuine humanitarian motives in a program of foreign investment, as well as economic and strategic purposes, then clearly governmental agencies are better fitted to participate than private investment organizations. On the other hand, it must be recognized that public lending agencies will be

subject to serious difficulties. They are more likely to be hampered or restricted by political opposition to the whole policy or opposition to particular features of interest to certain domestic groups or areas. They may be slower to act, particularly if they are international agencies requiring the cooperation of various governments. Finally, there may be danger of international political implications and complications arising from the investment, from the management of the newly developed projects, or possibly from default or delays in meeting the terms of the contract.

While it seems likely that a substantial part of this postwar foreign investment will take place through official agencies, there will almost certainly be considerable scope for private investment as well. If the major elements in the development program begin to show signs of success, and if openings appear for industrial and commercial investment within the larger framework, then one can count on some private capital moving in fairly rapidly. In particular, one would expect to see another wave of direct investment by large, established industrial and commercial concerns setting up their own branches or subsidiaries. This direct investment—though hardly the typical example of the economic textbooks—has been one of the most important and successful types of foreign investment, particularly by the United States. It has one great advantage for the type of program we are considering in that it provides a very convenient and effective way of introducing into new areas the most modern techniques and able management, as well as capital.

There are several matters relating to the transfer of capital from the lending to the borrowing country that we must note. The capital movement must somehow be reflected in a movement of goods or services; it must increase the exports of the lending country in relation to its imports and increase the imports of the borrowing country in relation to its exports. These changes need not, however, be confined to the direct trade between the countries. The capital may in effect be exported via third countries, to greater or less degree. The funds advanced by one country may be spent in another, which in turn uses them to import from the first, or from others who in turn will import from the first. In practice, a further complication is introduced by variation in exchange and gold reserves and in short-term balances, so that there may be a delay in the working out of these trade embodiments of the original capital movements.

It will be of the greatest importance whether or not the lending country requires that the proceeds of the loan (or the funds provided for other forms of investment) be spent in buying imports from itself. There may be some temptation for it to attach this requirement to loans made by public agencies, particularly in periods when difficulty is being experienced in maintaining a satisfactory level of employment. If this condition is attached to most of the foreign investment after the war, however, it will be a very serious impediment to the development of general, multilateral, international trade, for the imports required by the borrowing country would normally be obtained from several countries, and the borrowed funds would be fairly widely dispersed in paying for them and would serve to finance a whole series of multilateral transactions before finally returning to the lending country. In particular, it now appears that much of the world will for quite a period suffer a fairly chronic shortage of American dollars unless these are made available by substantial loans from the United States to those nations requiring capital, who in turn would be permitted to pay over the dollars to third countries where they will be needed to pay for an excess of imports from the United States.

The second point to be noted in relation to the transfer of the capital by means of goods (and services) is that it does not necessarily involve additional trade in "capital goods" but may be embodied largely in additional movement of consumer goods, even food. It frequently seems to be taken for granted that the export of capital by a country will take the physical form of export of machinery, steel, and other capital goods, possibly because the great lending nations have also been the great industrial nations. If one reflects that the substantial movements of capital after the war are likely to be to countries of large or fairly large populations at very low standards of living and the capital will be invested in construction projects probably to a greater extent than in machinery and equipment, then it seems probable that at least a part of the capital will be transferred in the form of food and materials, and other consumer goods, to sustain the local population that must be diverted to capital creation. Therefore, there is some chance that the large-scale movement of capital to the Far East may use up threatening surpluses of wheat, cotton, and other Western products not usually regarded as capital goods.

A third and most important transfer problem arises in the repayment of the loan or the payment of the interest on it. This

problem will not be an immediate one, fortunately; and, in the large-scale investment programs under consideration, it might not arise at all during the lengthy period when the investment is going on and not on a substantial scale until repayment of principal commences. When it does arise, the problem will be to find means of increasing the exports of the debtor country, relative to its imports, and of increasing the imports of the creditor country, relative to its exports. In part, but only in part, the ability to make this transfer will depend on the success of the investment program in developing a productive economy in the debtor country, which will enable it to produce the exports to pay for its obligations or to get along without imports to the corresponding extent. For the rest, the possibility of transfer will depend on the willingness and ability of the creditor nation to accept the additional imports of goods and services represented by the payments of the amounts owing to it or to accept a corresponding reduction in its exports. Experience in the last 20 years suggests that the debtors may be better prepared to meet their part of this transfer problem than creditors are to meet theirs. The creditor country's difficulties in accepting payment in real goods arise primarily from the fact that a change toward a more liberal tariff or other trade policy is hard to achieve unless or until a fairly high level of employment and production can be maintained at home. Consequently, the ultimate stage in a foreign investment program brings us back face to face with the problem of securing and maintaining full employment. If that problem can be solved in the creditor country by constructive methods rather than merely by excluding imports, then the repayment of foreign investments can be accepted in goods, and the people of the creditor country will stand to gain the very real advantages represented by the higher real rate of return which can be earned upon capital in the borrowing country. The more confidently we can look forward to continued success in achieving full employment, the more sense there is in a well-directed program of foreign investment.

It is not to be expected that a large program of foreign investment would be without risks and opposition. We have already noted the difficulties that may be faced in the transfer problem at the time of repayment. It is conceivable, though hardly very likely, that these ultimate difficulties would be made the basis of immediate opposition by vested interests. It is more likely that they would be cited by others to rebut a claim that the foreign investment would bring a real benefit to the lending country.

There will be risks of loss even apart from the transfer problem. The investments may not be efficiently or economically made and the return may be disappointing for that reason. This can be guarded against only by care and good management on both sides. There is also the danger that economic conditions in the debtor country in future years may, for other reasons, be so unsatisfactory that investments will not be so productive as anticipated and will neither yield a direct return nor provide a taxable capacity or local borrowing capacity that is sufficient to make possible the meeting of the obligations that have been incurred. The significance of this danger will depend upon the success of the whole development program in the debtor country and the international economic situation with which the country is faced at the time its obligations must be met.

In addition, of course, there will be what we may term the political risks. The form of government of the borrowing country may not be sufficiently strong or firmly based to offer much assurance that the country will be able to carry out the investment and development program in question or to meet the obligations it incurs for the purpose. To some persons this danger, for example, appears as a potential barrier to large-scale investment in China. One cannot assess the risks of this character until the shape of the postwar world is clearer than at present. One can expect, however, that a government able to obtain foreign capital and use it to develop its country and substantially improve the condition of its people will in that very process gain enormously in strength and prestige at home. If it has the assistance and cooperation of a friendly great power, its stability should be further augmented.

Another type of political risk is the danger that the government of a borrowing country may decide to default, or to force those within its control to default, even though the ability to pay is present. Some element of this danger may always be present. It may be expected to be less than has been usual in the past, if the loans are obtained at a reasonably low interest rate and are used to carry out a vigorous program of national development. If international economic conditions can be maintained on a fairly stable and favorable basis, in which national development programs can be expected to proceed with some real hope of success, then we may look forward to far less international distrust and friction than in the past and consequently far less danger of deliberate default or repudiation of obligations. Even fairly radical political

change would not necessarily lead to repudiation of international loans that were honestly obtained on reasonable terms and used for sound, productive purposes, for real development, and for the improvement of the condition of life of the people. There will be an added reason for honoring the contracts if the loans have been obtained from a friendly power whose good will any government would wish to retain. If the new government is one dedicated to a more vigorous program of social and economic development, it will undoubtedly wish to borrow more abroad and will have a material interest in meeting the obligations it will have inherited.

Once we can look forward with confidence to many years of secure peace between nations, the greatest of all political risks will be eliminated. Surely it will not be beyond the wit of man to achieve this all-important goal, after a decisive victory is won.

Chapter XXII

INTERNATIONAL MONETARY STABILIZATION

C. P. Kindleberger

So far as can now be judged, four principal factors of disequilibrium will exist at the conclusion of the period of relief and reconstruction after the war, to plague the establishment and maintenance of a free system of international trade and exchange:

1. The distribution of international monetary reserves will be more distorted than in the prewar period.

2. International liquidity will be more difficult to accord to national capital assets, not only because of shortages in foreign reserves, but also as a result of the increase in internal liquidity in all countries.

3. The long-run shift in the relative prices of finished goods and primary products, which has resulted in a steady worsening of the terms of trade of countries dependent upon exports of agricultural and raw commodities, appears likely to persist.

4. The "chronic world shortage of dollars," due partly to the height of American tariff protection and partly to the economic stagnation in the United States during the 1930's, but resting fundamentally upon the fact that the rest of the world feels the need of American products in greater value amounts than the United States requires foreign commodities, is likely to be accentuated as a result of the changes during the war.

Considerable progress toward the reconstruction of free, stable, and multilateral international economic relations will have been achieved if problems of war debts, including the costs of financing relief and reconstruction, are overcome by treating national war expenditures in behalf of allies as direct costs of war which do not give rise to international obligations.[1] An attempt to collect reparations from the defeated enemy, which would further complicate the problem of international economic adjustment, is also unlikely to be made on the basis of past experience. Yet it should

[1] See *Fifth Report to Congress on Lend-lease Operations* (Washington, 1942), pp. 21–23.

be remembered that the disintegration of the international economic system during the interbellum years continued to take place at a rapid pace during the decade of the 1930's, after war debts and reparations had passed from the international scene as live issues.

CRUCIAL PROBLEMS FOR INTERNATIONAL STABILITY

The inability of the world to cope, prior to Sept. 1, 1939, with the four factors of disequilibrium just listed was fully evidenced by the growth of bilateralism, trade discrimination, foreign exchange control, and clearing agreements. The war in its progress to the end of 1942 has accentuated the potential disruptive powers of these factors in the postwar period.

1. The facts relating to the concentration of monetary gold in the United States, the loss of British gold, foreign balances, and foreign securities, the accumulation of blocked sterling by Empire and other countries, etc., are too well known to require repetition. It may be noted, however, that the Lend-lease Act in the United States and the Canadian provision for a billion-dollar gift to Britain, both initiated because of the inability of the United Kingdom to finance its North American purchases out of income or capital, have halted British losses of foreign assets in these countries.

2. The problem of international liquidity, familiarly known before the war as the "hot money" problem, has been effectively disposed of for the period of the war by foreign exchange control. If exchange controls are to be removed after the war, however, the problem must be dealt with. Even apart from the question of confidence in currencies, hot money will be troublesome because the proportion of liquid to total assets[1] has grown enormously in all countries. Currency in circulation, central bank deposits, commercial and savings bank deposits have increased markedly, while physical capital assets have been consumed for war purposes. At the same time, the distinction between government debt and cash has narrowed as governments have given explicit and tacit undertakings of stability of interest rates during and after the war. Savings bonds in the United States can be redeemed 60 days after issue at any time without notice, and similar special securities have been sold to the public in many countries. Ordinary government bonds are so widely held by the public, corporations, and banks that any reversal of the cheap-money policies pursued during the

[1] See A. A. Berle, Jr., and V. Pederson, *Liquid Claims to National Wealth* (New York, 1934).

war would be likely to meet with extensive political opposition and endanger the safety of important national institutions. Cheap money has been adopted as an immutable policy of finance during the war when capital is scarce; it would appear virtually impossible to dispense with after the war when the need for capital is reduced, the danger of deflation threatening, and a heavy load of war-contracted debt must be carried by governments.

If money remains cheap after the war, government debt in the hands of the public in all countries will be convertible into cash with a low risk of loss on principal. The increased liquidity of national assets will accentuate the problem of providing international liquidity. Capital flight will be a greater peril to a country's international monetary stability. If free exchange markets are maintained, the ease of converting national assets into cash will lead to increased attempts to distribute the risk of capital loss internationally.

3. The trend in the terms of trade against primary products in favor of industrial goods may be expected to continue after the war, unless further steps are taken to correct it, because of the wartime expansion in agricultural and raw-material capacity and the accelerated development of manufactured substitutes for natural commodities.[1] That this trend has been disturbing to the maintenance of international trade equilibrium under an open system cannot be doubted. The shrinkage of markets in general gives monopolistic advantages to markets which remain available. By making full use of the power of their bargaining position, large-scale importing countries can require the countries from which they buy to buy from them. Once involved in bilateral clearing, moreover, primary producing countries are vulnerable to attempts further to reduce agricultural and raw-material prices or to raise quotations on industrial goods. The long-run shift in the terms of trade has opened opportunities for government intervention on a discriminatory basis in the pricing and distribution of goods in international trade.

[1] Reviews of Colin Clark, *The Economics of* 1960 (London, 1942), which is not yet available at the time of writing, indicate his view that a new shift in the terms of trade in favor of primary products will occur in the near future. This position does not necessarily conflict with that expressed above, since Clark apparently expects the steps necessary to reverse the trend—the expansion of purchasing power and productive capacity in the economically backward areas, and the further industrialization of primary producing countries—will in fact be taken.

The reasons underlying this movement in the terms of trade can be illustrated by reference to agricultural products. The inclusion of raw materials complicates the analysis but does not greatly modify its conclusions.

The terms of trade have moved against agricultural products and in favor of industrial commodities because of differences in the institutional organization of production in the two fields, on the one hand, and in the character of the demand for them, on the other. The differences in the organization of production need not be elaborated. In various quarters it is urged that they be narrowed by national and international acreage controls and international agreements to stock-pile surpluses on the "ever-normal-granary" principle, as far as agriculture is concerned,[1] or by the destruction of monopolistic practices in industry. The fact that the demand for agricultural products as a whole is relatively inelastic and the demand for industrial products relatively elastic, however, presents a far less tractable problem. As productive efficiency improves in agriculture, factors of production must be shifted out of agriculture into manufacturing or service industries, because the demand for agricultural products is limited; as productive efficiency increases in industry, on the other hand, an over-all expansion in industrial output as a whole is possible.[2]

The possibility of technological unemployment in agriculture calls into question a fundamental assumption on which the case for international specialization rests. Greater efficiency in agricultural production can raise the real income of a country dependent upon exports of the agricultural product only if labor freed from the land is able to migrate abroad, or, where migration is impossible for political reasons or for inability to accumulate the capital initially called for, when industry is developed within the country. This industry need not be so efficient as industry abroad. The real income of the country will be increased if, at some level of costs,

[1] See L. A. Wheeler, "Agricultural Surpluses in the Post-war World," *Foreign Affairs*, Vol. 20, No. 1 (October, 1941), pp. 87–101.

[2] This discussion omits consideration of population trends, synthetic industry, and other new sources of demand for agricultural products, the role of better nutrition, and many other relevant aspects of the problem. It should be pointed out, however, that malnutrition, for which more production of protective foods is needed, raises the ceiling on total agricultural output but does not vitiate Engel's law. It is further significant for the world problem that Engel's law does not apply where the standard of living hovers at or below the subsistence level. In this area, Malthus's law applies instead.

labor displaced from agriculture can produce industrial products previously imported to enable part of the proceeds of an unchanged volume of exports to be spent upon other types of imports.

If neither migration nor industrialization occurs, the terms of trade of the country experiencing an increase in productive efficiency in agricultural products will move against it, and the country will have made no gain from the increased output. The terms of trade may even move so far that the country experiences a net loss in real income as a result of an increase in efficiency in the exporting industries.

4. The concept of a chronic world shortage of dollars is perhaps too complex for full analysis in a paper of this length. That a shortage exists is supported by the fact that the balance of payments of the United States has recorded surpluses on current account in all but 2 years since 1919 and the fact that the merchandise trade balance of the country has been favorable each year since the large-scale capital imports of the 1870's. The small balance of payments deficits in 1936 and 1937 occurred during a period of heavy inventory accumulation and drought.

The difficulties encountered by foreigners in obtaining adequate supplies of dollars are "blamed" on United States tariff policy or on the fact that during the 1930's United States recovery lagged behind that of other countries as compared with 1929. These explanations fail to make clear why a new equilibrium is not established when United States tariff barriers are raised, after simply a transitional shortage of dollars; and they fail to push the analysis of higher United States income and ensuing higher imports to the impact of these in turn on the purchases of foreign countries in the United States.

At basis the explanation for the chronic world shortage of dollars is to be found in the technical superiority of the United States in the production of many goods necessary to a high modern standard of living and to the natural desire in other countries to raise real incomes faster than the basic conditions of their economic productivity justify. The United States has large and fairly balanced natural resources, relatively modern and efficient capital equipment, a comparatively small population in relation to natural resources and capital equipment, but a large domestic market for the output of its own mass-production industries. The United States can produce a variety of producers' and consumers' goods with a price and quality advantage so great as to be almost absolute. The

advantages of other countries over the United States in the production of other industrial goods are relatively narrow. Under these conditions, the law of comparative advantage can establish equilibrium in international trade only with great difficulty, especially since technological advance is being made in the United States and abroad at a rapid pace.

The fact that other countries want to increase their standard of living faster than the facts of their economic productivity justify can be expressed in the statement that the demand of the rest of the world for American manufactured products[1] is highly elastic with respect to income and price, whereas the United States demand for foreign products is relatively inelastic.[2] It can be demonstrated that disequilibrium in trade relationships will be brought about if national money incomes increase by a similar percentage in two countries, one of which has an inelastic demand for the goods of the other, while the demand of the latter for the goods of the former is elastic. If the ratios of exports to national income in the two countries also differ, further disturbances result.

Assume country *A* with a low marginal propensity to import (low elasticity of demand for imports with respect to income), and country *B* with a high marginal propensity, trading exclusively with one another. From a position of equilibrium in trade, an autonomous rise in national money income of an equal percentage in

[1] The foreign demand for American primary products is, of course, subject to the influences of the long-term shift in the terms of trade, as well as to the economic forces in the United States, which have lately assumed political forms, tending to bring about equalization of incomes. Compare the shrinkage of American foreign markets for lard, wheat, cotton, tobacco, fruit (other than citrus), etc.

[2] That the American market can be sold by modern methods is illustrated by the success of Czechoslovakia in developing outlets in this country for sales of pottery, glass, shoes, gloves, and other leather goods, during the interbellum years. The "Corporacion para Promocion del Intercambio," organized by American exporting interests in Buenos Aires to promote the sale of Argentine products in the United States, was apparently achieving considerable success in 1941, until shipping difficulties curtailed its operations.

The American demand for raw materials is, of course, derived. The influence of this fact on the course of imports is so strong that the volume of total imports fluctuates closely with the physical volume of industrial output in the United States, as measured by the Federal Reserve index. This relationship is so marked, moreover, that no distortion in the correspondence appears to have resulted from the imposition of the Smoot-Hawley Tariff Act of 1930 or the tariff reductions under the Trade Agreements Act of 1934.

relation to the preexisting level occurs in each country. *A*'s imports from *B* will rise somewhat, but *B*'s imports from *A* will rise considerably. National income in *A* will receive a further stimulus from the favorable balance of trade; national income in *B* will tend to decline from the new level. If a new trade equilibrium is to be established (assuming no change in the exchange rate, demand schedules, or other conditions of trade), national income must rise still higher in *A*, decline in *B*, or both. If the original increase in national money income were sought in both countries, say, in order to eliminate a certain amount of unemployment, and a strenuous attempt made to maintain it, the equilibrium of the trade position cannot be restored.

When *A* has a low marginal propensity to import and is only slightly dependent upon export trade, and *B* a high marginal propensity to import and is heavily dependent on exports, adjustment becomes much more difficult. An autonomous rise in the national incomes in *A* produces a small increase in imports from *B*. The rise in *B*'s exports, however, results in an increase in incomes in *B*, most of which in turn is spent for imports from *A*. This rise in imports may be larger than the increase in exports which prompted it, with the result that the original stimulus to the favorable balance of trade in *B* eventually produces an unfavorable balance. The maintenance of trade equilibrium in a world where these conditions obtain is a difficult task.

It may be suggested that the United States has a comparatively low propensity to import and a low ratio of exports to national income, whereas the rest of the world has a relatively high elasticity of demand for United States exports of manufactured goods and a relatively high ratio of exports to income. If this be true, and if the foregoing analysis be applicable to the postwar situation, additional dollars made available to foreigners by increased United States imports may lead to a greater increase in foreign expenditures for American products, leaving the world still short of dollars. This is not to gainsay the desirability of lower American tariffs, since the shortage would still occur at higher levels of real income. It simply underlines the conclusion that a reduction of the American tariff is not of itself an adequate solution for the world shortage of dollars and that the earnest admonitions of the rest of the world to the United States that it "live like a creditor nation" fail to come to grips with the fundamentals of the problem.

THREE UNORTHODOX SOLUTIONS

The types of solutions appropriate to the problem of establishing and maintaining a free system of international trade and exchange after the war may be illustrated by the analysis of three recently advanced proposals: (1) the Feis plan, (2) the Twentieth Century Economic System, and (3) pool clearing.[1] These are all variations of an essentially similar idea, to use international clearing as a substitute for or a complement to an open exchange market.

Feis's plan, which he describes as a suggestion for a "Trade Stabilization Fund or Budget," calls for the United States to make $3 or $4 billion available to foreign nations as a minimum annual budget for payments to the United States for goods, services, or debts. This sum would be allocated among various foreign nations by negotiation. Foreign countries drawing against the minimum credit assigned to them would credit the United States with an equivalent amount of their own currencies, computed at agreed rates of exchange, or of other foreign currencies as agreed upon. These credits in turn would be drawn upon as the United States spent dollars—which would be paid in to the authority handling the plan—for foreign goods and services. If a balance of dollars credited to foreigners, or of foreign currencies credited to the United States, were left unspent at the end of a specified period of time—Feis suggests 2 years—the unspent sums would be canceled. As the use of the plan developed, it would be expected that all countries would credit all other countries with minimum budgets of local currency at the beginning of each trade year, at agreed rates of exchange alterable by negotiation. Feis also anticipates that private markets for foreign exchange, free of government control, would grow up outside the confines of the minimum budgets, to provide media of international payment for capital movements, trade in excess of minimum requirements, gold flows, etc.

[1] See Herbert Feis, "Restoring Trade after the War," *Foreign Affairs*, Vol. 20, No. 2 (January, 1942), pp. 282–292, and Anonymous, *A Twentieth Century Economic System*, pamphlet (London, 1941). The third proposal has been put forward in an unpublished, privately circulated memorandum, and provides for a system called *pool clearing*. It is perhaps unfair to analyze pool clearing, when the reader is unable to test the validity of the analysis against the text of the proposal. The reason for so doing, however, is that the proposal in question is the most able presentation of the basic idea common to the three schemes.

An earlier variant of essentially the same idea is advanced by Edgard Milhaud, *A Gold Truce* (London, 1933). Chapter VII is particularly worth examination as an attempt to answer all possible objections to the plan.

The plan outlined in *A Twentieth Century Economic System*, endorsed by the London Chamber of Commerce,[1] involves less elaborate machinery. It starts with an international convention, in which the participating countries agree on a series of exchange rates. Exporters draw foreign currency bills against foreign purchasers, discounting these bills for local funds with their respective national exchange-control authorities, which debit the importing country. Importers make payment for purchases from abroad in local currency to their respective exchange authorities, which credit the exporting country. The exchange control of a country with a surplus of exports over imports vis-à-vis another country builds up a claim on that country which can be reduced only by importing further amounts of its goods. Otherwise the latter is entitled to cancel the credit after 7 years.

The author states that multilateral trade could be provided by the creation of an international exchange, where blocked credits in one country could be canceled against debits in another at the conventional rates. He is opposed, however, to holding all credits and debits with the international exchange. He considers it important that countries owning uncanceled credits recognize in which countries these have arisen, in order that they can "take steps to clear those credits either by taking more imports or restricting exports to them."

The third proposal, that for pool clearing, is similar to the Twentieth Century Economic System plan but is shorn of its strongly bilateral tendencies and without specific provision for the cancellation of unused surpluses. Each country establishes a national clearing fund, and together all countries establish an international clearing office. Exporters obtain payment by drawing bills on importers abroad and discounting these bills at the national clearing fund. The latter pays the exporter by borrowing local funds from the central bank and registers a claim with the international office. Importers pay their national funds for foreign merchandise. In this case the national fund repays loans to the central bank, and its credit at the international clearing office is canceled. The international office regards net claims from all net exporting countries as offset by balances accumulated in net importing countries as a whole, without identifying particular claims with balances in particular countries. The persistent accumulation of deficits by a country

[1] See *Report on General Principles of a Post War Economy*, pamphlet (London 1942), p. 11.

will require: (*a*) the funding of deficits into loans or exchange depreciation, in the case of countries the trade of which is only technically out of balance; (*b*) enforced depreciation or exclusion from the system on the part of countries continuing to import but unwilling to export; or (*c*) no action at all, *i.e.*, the continuous accumulation of balances in the case of countries ready and able to sell abroad, but from which the world is unwilling to buy. Surplus countries run some risk of loss through depreciation of the claims they have amassed against deficit countries. It is felt that they can be relied upon to increase their imports from the world as a whole (not the deficit countries alone), in order to keep down cumulative and unmanageable surpluses which represent barren investments and run the risk of loss.

These brief summaries fail to do justice to the specific plans put forward but may indicate their broad outlines. In general, the proposals are designed to relieve countries with chronic deficits in their balances of payments on current account from the sole necessity to undertake adjustments and to shift the bulk of the burden to surplus countries. The Twentieth Century System is frankly bilateral; the Feis plan tries to rid itself of evident bilateral features by leaving room for the negotiation of balance transfers; pool clearing makes a valiant attempt to avoid bilateralism,[1] but it is not at all certain that the plan would operate successfully in this connection.[2] All three systems depend upon foreign exchange

[1] The objections to an international system of settling trade bilaterally are obvious and compelling. In prosperous times, the United States buys $200 million of tin and rubber from British Malaya and sells that country some $25 million of American goods. To force a bilateral balance would involve a reduction in American tin and rubber imports or an increase in Malayan imports from the United States, the latter in the face of cheaper goods available in the Netherlands Indies, Japan, and perhaps the United Kingdom.

Under the Feis proposal, the interested governments would negotiate the distribution of the British Malayan export surplus against the United States, which would require government distortion of trade unless it were possible to elaborate a system which, prior to the fact, would distribute the surplus in the same way that dynamic forces of a free market would have dictated. The Twentieth Century System also makes allowance for negotiated transfers of balances, but, under the case cited, appears to insist that, if the United States has an over-all deficit, or British Malaya an over-all surplus, some special merit attaches to corrections in the mutual trade between these countries as a means of arriving at the needed adjustments. Subjecting transfers of surpluses and deficits to government negotiation in any case seems to retain the likelihood of trade rivalry and discrimination on a political basis.

[2] If one or two countries accumulate large surpluses and one or two countries

control to ensure that trade transactions are in fact handled through the mechanism set up for the purpose; the Feis plan ostensibly leaves room for freedom of exchange transactions outside the trade stabilization fund, but these transactions have to be examined to ensure that they do not include deals which belong inside, say, imports on the part of a country which has credits abroad to be used up. The Twentieth Century System is not opposed to trade adjustments in the form of export restrictions by surplus countries: the Feis proposal, put forward to assure countries of import minima, and pool clearing are evidently averse to this method of adjustment.

To get back to the four factors of disequilibrium:

1. All three proposals evidently fill the immediate need of countries which will be left after the war without adequate monetary reserves. If any of them were adopted, no nation need retain its controls over trade transactions for fear of being unable to pay for imports or in order to reconstitute a monetary reserve of appropriate size.

2. The Twentieth Century System and pool clearing meet the problem of international liquidity by providing for exchange control which presumably forbids any but official capital movements that are undertaken to fund surpluses and deficits in balance of payments. Provision under the system could, of course, be made for more latitude in capital movements. The Feis plan purports to allow for freedom of exchange transactions outside the "trade stabilization budget device." It is evident, however, that exchange surveillance is required outside this area, and it is not clear how the plan expects to make movements of short-term capital manageable outside the system. In all three cases, the meeting of the problem of lacks of monetary reserves will serve to increase confidence in currencies, at least for a period. If deficits pile up continuously against a country, however, a movement of the exchange rates may be anticipated, at least under pool clearing, which would provide a stimulus for exchange speculation. Under these conditions, the exchange control necessary to operate the system at all would probably be used to prevent short-term capital movements on private account.

3 and 4. Where these proposals fall short of providing an adequate basis for the reconstruction of international stability in

large deficits at the international clearing office, it is hard to see how the adjustments on the part of the surpluses countries could avoid being put on a bilateral basis.

world trade and exchange is in their lack of correctives for the deep-seated factors of disequilibrium discussed above under the headings of the trend of the terms of trade against primary producing countries and the chronic world shortage of dollars. The proposals rely on various means of adjustment: (*a*) consciously promoted increases in imports by surplus countries; (*b*) consciously promoted decreases in exports by surplus countries; (*c*) exchange depreciation on the part of deficit countries, or exchange appreciation on the part of surplus countries; (*d*) the conversion of unsettled balances into gifts from surplus to deficit countries.[1] The effectiveness of these measures of adjustment may be tested against the two disequilibrium factors.

(*a*) To rely on increased imports by industrial countries to correct the shift in the terms of trade against primary-producing countries is futile in the long run, since at higher standards of living a country wants a greater proportion of industrial goods relative to primary commodities. In the short run, the position is complex. An industrial country with substantial resources, engaged domestically in primary production, may benefit by shifting resources from, say, agriculture to industry, importing more agricultural products from abroad. In this instance, the migration of labor from agriculture to industry occurs within the surplus country rather than from the deficit to the surplus country. In highly industrialized countries like the United States, however, a shift of labor from agriculture to industry is already taking place to adjust for the increased efficiency of domestic agriculture. It has not proceeded in peacetime fast enough to absorb all the domestic labor freed from agriculture; it is difficult to see how it could be speeded up, in view of the economic barrier to such migration on private account—lack of capital—and because of political and institutional frictions. The inducement to a more thoroughgoing shift provided by the piling up of current account surpluses under,

[1] It may be noted that, while the various authors do not explicitly rely on expansion or contraction of money incomes as a method of adjustment—such as are called for under the "gold standard," which has been politically repudiated on this account—the three proposals do involve such changes. To take the simplest example, under pool clearing, a surplus country borrows from the central bank, which directly enlarges national income and expands the credit base; the deficit country builds up idle balances at the central bank, which contracts money incomes directly and the credit base. To be sure, further central bank or treasury operations could offset these inflationary and deflationary effects.

say, the pool-clearing scheme, would have little effect in view of the domestic resistances.

If a country like the United Kingdom were to accumulate surpluses under the pool-clearing scheme, there would be almost no incentive to increase agricultural imports. The operation of Engel's law in the long run makes it impossible for these schemes to solve the problem of adequate terms of trade for primary products.

Will surpluses accumulated by the United States under the pool-clearing scheme lead to increased imports by the United States which will be sufficient to correct the chronic world shortage of dollars? The analysis of the dollar shortage above suggests that it will not. The United States could import more finished goods at any level of production, can import more raw materials at higher levels of production, and might import more agricultural products to the extent it succeeds in moving factors of production already engaged in agriculture into industry. But these increased imports will raise money incomes abroad and will produce increased demands for American products in excess of the original increases in American imports.[1] The chronic shortage of dollars would remain, albeit at higher levels of real income throughout the world, and the United States would continue to pile up surpluses.

The gold accumulated by the United States during the 20 years prior to the war has not succeeded in inducing an expansion of United States imports which was not followed by an equal or greater rise in exports. This gold represents an investment as cumulative and as barren as claims on foreign countries and is increasingly recognized as such by the man in the street and in vaudeville jokes. Perhaps claims on an international clearing office would provide a greater inducement than gold to stimulate imports. In any event, it may be doubted that increased imports would correct for long the world shortage of dollars.

[1] The Argentine experience of 1936–1938 reveals the effects of a high dependence on foreign trade and a high propensity to import on the balance of payments adjustments. The North American drought of the summer of 1936 raised world prices of wheat and corn. Argentina with large crops of those cereals enjoyed an enormous export surplus during the 1936–1937 season, using some of the proceeds to pay off debt. After a normal lag, money incomes in Argentina rose sharply. Imports followed the rise in income, and orders were placed for substantial quantities of American automobiles, etc. Even if the gain in exports had been sustained in the following year, Argentina would have found itself with a large import surplus which had to be corrected by foreign-exchange-control measures, directed primarily against imports from the United States.

b. The adjustment of trade through reductions in exports by surplus countries has already been shown to fall short of the desires of the authors of two of the proposals under consideration. To limit exports of industrial products to primary producing countries will, of course, widen the terms of trade between primary and industrial commodities. The same measure fails to solve the problem posed by the world chronic shortage of dollars, since the demand for dollars is in effect an insistent expression of the deemed need for American goods. To reduce the amount of goods available would meet the problem, but in a highly unsatisfactory fashion.

c. The author of the plan for pool clearing gives great weight to exchange depreciation as a solution for deficits which arise as a result of trade disequilibria. "Experience shows that the elasticity of *total* demand for import and of the *total* foreign demand for a country's exports is always such that, at one point or another, depreciation can effect a balancing of trade." Issue may be taken with this statement on two counts. Some experience, that of Germany in 1922 and of the United States in 1932, suggests that exchange fluctuations need not result in a balancing of a trade position; in addition, the type of trade adjustment brought about by depreciation may not be the most desirable one.

Rather than recount the complicated experience of Germany, a possible case to be encountered in the postwar period may be examined. Assume that country X has lost foreign assets, on the earnings of which it depended for a considerable proportion of its income from abroad; X is resolved to maintain its standard of living, and in fact to improve it through a nationwide program of reconstruction and rehousing; it has an unfavorable position in export markets, the demand for its products being relatively inelastic with respect to price, and many of its exports are manufactured of imported raw materials; X's demand for other imports is inelastic since these consist of foodstuffs and raw materials for domestic consumption. Under these circumstances, depreciation will be slow in raising the value of exports and may increase the over-all value of imports in terms of X's currency. If, in addition, wage rates are tied to changes in the cost of living, the expansion in the total value of exports may not occur at all. Under these and other imaginable circumstances, exchange depreciation is a very clumsy device and may prove ineffective because of progressive inflation at home.[1]

[1] See Geoffrey Crowther's discussion of the British postwar shortage of

Exchange appreciation, on the other hand, may be matched *pari passu* by deflation so that the appreciation of the currency does not stimulate an increase in imports nor restrict exports. This is strongly suggested by the experience of the United States when the pound sterling fell from $4.86 in 1931 to $3.12 in 1932, even though the deflation in the United States did not originate solely or mainly in sterling depreciation. Deflation kept up with the appreciation of the dollar, so that the current account balance continued favorable at the highest values of the dollar.

Exchange fluctuations will doubtless correct balance-of-payments difficulties in the usual case, but they do so, like reductions in exports by the surplus countries, by frustrating the economic forces which make for disequilibrium. In the case of countries with trade deficits resulting from a worsening in the terms of trade, exchange depreciation is likely to balance the position by ensuring that the country obtains less imports for a given or slightly larger volume of exports. Such depreciation will redistribute income within the country and may be desirable in diverting real income from the mass of the consumers to export producers. It is hard to see, however, that it can alter, and it may perpetuate, the distribution of the factors of production between primary and industrial occupations which give rise to the growing disadvantage to the exporting groups.

d. The cancellation of unsettled balances may or may not correct the deep-seated disturbances which give rise to trade disequilibria. If the trade deficits forgiven represent imports of capital goods, which will increase the productivity of the deficit countries in appropriate lines, their financing by cancellation will tend to promote long-run equilibrium. If, on the other hand, the deficits arise from consumption and the underlying situation as to economic

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dollars in "Anglo-American Pitfalls," *Foreign Affairs*, Vol. 20, No. 1 (October, 1941), p. 11: "In the classical theory of the free exchanges a situation of this sort would be corrected by a depreciation of the pound, which would cheapen British goods in America and make American goods dearer in the sterling area. But in this particular case it is questionable whether the remedy would work. British goods do not, in general, sell on price in America. . . . On the other hand, many of America's exports to the sterling area, particularly the automobiles and machinery, are virtual necessities for the maintenance of industry and trade. It would be rash to go so far as to say that there is no rate of exchange between the pound and the dollar which would balance the accounts in a free market. But it would have to be a very severe depreciation, which would hardly be welcome in either country."

productivity remains unaffected, cancellation, or making a gift of the surplus, is a palliative which must be maintained so long as the system is kept in operation.

Where there is a long-run tendency for the terms of trade to move against primary products in favor of industry, factors of production must be shifted from agricultural and raw-material production into industry. To the extent that the necessity to make gifts brings this about in the surplus country, which is presumably already largely industrial, the necessity to cancel surpluses will improve the basic situation. But the prospects in this connection are unlikely to provide an adequate solution in the long run, as pointed out under *a* above. Where the deficit (loans) in the agricultural country is utilized to finance domestic industrialization, the cancellation of the deficit produces a real improvement in the situation. If deficits on the part of the primary-producing countries arise from expenditures on consumption goods abroad, the cancellation of such deficits will continue to be necessary in the future.

Similar reasoning applies to the problem created by the world shortage of dollars. If dollars are made available to the rest of the world to finance a higher level of consumption than would otherwise obtain, the system may be counted upon to be a perpetual one. Where, however, the dollars are given to foreign countries to enable them to narrow the gap between their efficiency in production and that of the United States, *i.e.*, to finance capital formation abroad, the cancellation of United States trade surpluses will tend to correct the fundamental disequilibrium in the international trade position.

It is politically difficult to justify gifts from surplus to deficit countries on either of these grounds. An increase in public debt in the United States to finance more effective resistance to the Axis and a somewhat higher standard of living for United Nations is deemed appropriate in time of war on the principle of equality of sacrifice in the attainment of a mutually sought end. In peacetime, with wide variations in the standard of living within the United States, it is doubtful whether use of public funds to increase consumption abroad would be politically supportable, except in cases of desperate need. It would also be politically difficult to justify gifts of capital equipment abroad. Capital equipment is productive and can pay for itself with a portion of the increased output it makes possible. If the United States is not ready to receive added

imports when repayment is offered, the funds repaid can be reinvested abroad.

Britain in the nineteenth century had a technical superiority in the production of industrial products and lent abroad on a large scale to finance the spread of industry abroad. If Britain had stopped lending for any reason, while it retained its margin of superiority, there would have been a world shortage of sterling and a plea for renewed loans rather than for Britain to restrict its exports or to "act as a creditor nation." Britain continued to pile up surpluses for reinvestment until the First World War, and has acted as a creditor nation as far as the whole balance of payments on current account is concerned, only since 1914. For Britain to have given away the advantages of its superior productivity during the nineteenth century would have been unthinkable at that time.

To sum up: the three proposals put forward cannot be expected to solve the deep-seated disturbances in international trade and exchange through voluntary increases in imports by the creditor countries, by reduced exports of such countries, or by exchange-rate adjustments. To the extent that these proposals at basis resolve themselves into gifts from surplus to deficit countries, they may or may not help to correct the disturbances. The proposals may therefore be taken as inadequate to meet the basic needs of the postwar period.

ORTHODOX PROPOSALS

Can international monetary stabilization then be achieved through the more orthodox techniques of gold purchases by surplus countries, or by the formation, by surplus and deficit countries alike, of an international stabilization fund? The system of gold purchases, which the United States practiced from the passage of the Gold Reserve Act of 1934 to the Lend-lease Act, evidently fails to clear the first hurdle—the fact that most of the countries of the world no longer possess adequate gold reserves. On the second score, hot money, the proponents of gold insist that confidence in currencies can be maintained only through basing national currencies on gold reserves.[1] This position is debatable. As far as

[1] See any journal catering to a financial audience interested in gold-mining securities, especially *The Northern Miner* (Toronto), *The Financial Post* of the same city, and *The Financial News* (London).

the tendency for the terms of trade to move against raw-material-producing countries is concerned, gold purchases are on the whole neutral, except possibly in some areas where the alternative to employment in gold mines is more intensive use of labor in agricultural pursuits. The real contribution which the gold purchase system makes, however, is in its easing of the world shortage of dollars. So long as the United States is prepared to monetize gold more readily than other claims upon foreign goods, $1,200 million are made available to the world annually against foreign new gold production.

Despite these advantages to the system of gold purchases, it is abundantly clear after the experience of the last decade that there is nothing inherent in the limping type of gold standard practiced before the war which tends to correct disequilibria in international economic relationships. The open system of international trade based on gold broke down completely in spite of the attainment of new high records by gold production.

An international stabilization fund with large resources would, like the unorthodox proposals, obviate the necessity for a redistribution of international assets and might contribute effectively to confidence in national currencies. The collection of international assets in the fund could be made available to countries with temporary balance-of-payments difficulties for a sufficient period of time to enable disequilibria of an ephemeral character to be corrected. Surplus countries would be paid for their excess of sales over purchases, so long as their original contributions to the fund sufficed for this purpose. Loans by the fund to deficit countries would have to stop, however, when the assets of the fund were fully engaged in unpaid previous loans, unless further contributions from the surplus countries were forthcoming.

It should be observed that neither gold purchases nor an international stabilization fund are far different from the three unorthodox proposals outlined above. Under the system of gold purchases, surplus countries receive payment for their excess of sales over purchases in a conventional commodity which they can monetize. Under the Feis plan, the Twentieth Century Economic System, or pool clearing, however, surplus countries could monetize this excess in a sense by financing it at the central bank. The surplus could, on the other hand, be financed by the national treasury, but this is entirely similar to the policy of gold sterilization followed by the United States Treasury in 1936–1937.

An international stabilization fund requires financing by the contributing countries which can be undertaken out of central bank credit or budgetary receipts. So long as the country maintains a balanced position in trade, the line of credit or collection of assets allocated to the stabilization fund has no effect on the economy. When a surplus occurs, however, new central bank funds are made available to the market, or a budget deficit must be financed (or a budgetary surplus reduced). The result of the surplus is inflationary in its effects on national income, whether under the gold standard, pool clearing, an international stabilization fund, or any other type of conceivable formula.

The strong kinship of gold purchases and an international stabilization fund with the three proposals for righting world trade discussed above does not mean that these devices must inevitably be discarded because the unorthodox proposals were found to fall short of their objectives. Within a limited sphere, an international stabilization fund can make an effective contribution to monetary stabilization, by providing a collection of international assets for short-term use. Its proponents, who claim for it a broader objective, or the perpetuation of monetary stability through a formula—*e.g.* a country can borrow up to 2 per cent of its national income from the stabilization fund to finance trade deficits, but thereafter in order to qualify for further loans it must depreciate its currency by 3 per cent—these advocates are simply more timid than the authors of the unorthodox schemes discussed above.

THE NEED FOR LONG-TERM CAPITAL MOVEMENTS

While some new international monetary machinery, such as a stabilization fund, may make an effective contribution to international monetary stability in the short run, the effective basis for such stability must be found in a revival of long-term capital movements. The authors of the three unorthodox schemes already discussed and most of the advocates of gold standards, international stabilization funds, etc., aim at achieving a balance in the current-account position of most countries and hope to keep these accounts perpetually in balance. In so doing, they are waging war against the fundamental economic tendency for the rewards of like factors of production to move toward equality.

Within an area or region where factors of production have mobility, the tendency for incomes of like factors to achieve equality can be observed in practice as it is recognized in theory. Where

mobility does not obtain, it once was possible for unequal incomes to be received by similar factors of production over long periods of time without stress or strain on political or economic institutions.

It may be doubted, however, whether wide inequalities in incomes received by like factors of production can endure for long today without some conscious effort to narrow them. While the physical mobility of the overwhelming majority of the world remains limited, there is great mobility of ideas, including the idea of what constitutes an adequate standard of living. Ease of communication of thought is a twentieth-century commonplace; but the consequence that like factors of production are beginning to insist upon a greater approach to equality of real incomes in spite of lack of mobility is barely beginning to be realized.

The desire for greater equality in standards of living and its continued frustration lie close to the basis of the international disequilibrium of the twentieth century. Primary producing countries insist that if they are capable of producing more goods they should be privileged to consume more of the types of goods they want. Dollars are chronically short because the world wants American products in order to enjoy a high standard of living directly, or in order to have the use of the most efficient tools for producing desired goods.

International monetary stabilization, therefore, must be sought in a wider area than that circumscribed by pool clearing, stabilization funds, gold stocks, hot money, interest rates, or even budget balancing. The need of all countries for adequate monetary reserves may be readily handled if steps are taken to assure that these reserves will not be quickly dissipated by capital flight or through uneconomic imports. Faith in currencies can be restored in the short run, but confidence adequate for an open system of international exchange must wait on a trend which promotes rather than frustrates income equalization.

It must be accepted by the economist that large-scale migration cannot be relied upon heavily to achieve the desired equalization of incomes. Some migration will be possible, from the most densely overpopulated areas in terms of natural resources, capital equipment, and the standard of living to which the population has been accustomed, to underpopulated and developing countries. Principal reliance, however, must be placed upon the spread of capital equipment and modern techniques of production. The movement of the terms of trade against primary products can be

halted by improving still further productive efficiency in agriculture and raw materials, at the same time that domestic industrial opportunities are realized as fully as possible. The world shortage of dollars can be met by the spread of American, British, German, Swedish, and other modern production techniques throughout the world, together with sufficient capital to put them into operation.

Monetary stabilization, therefore, rests fundamentally upon the resumption of long-term capital lending on a significant scale. Proposals which ignore the basic problems of stability and aim merely to provide temporizing means to fill the gap in balance of payments on current account are doomed to fail.[1]

[1] Mr. Bryce, in this volume, discusses more fully the problem of long-term loans.—Editor.

PART VIII

Postwar Controls

CHAPTER XXIII

ON PRICE CONTROL AFTER THE WAR[1]

JOHN D. SUMNER

Price has long been recognized by economists as the central problem of economic analysis. Consequently, the manner in which prices are made is as accurate an expression as we may find of the organizational character of the economy as a whole. The question of price control after the war, therefore, is a topic of unusual interest and difficulty. Since a discussion of this subject perforce involves reference to the broad organization of economic life, it scarcely need be said that a brief essay has value chiefly as it directs attention to issues central to the development of price regulation after the termination of the present conflict.

The present essay is exploratory in character. It purports to be no more than a speculative reconnaissance of certain influences and issues. Questions will be posed which may contribute, by way of emphasis and suggestion, to what necessarily must be a continuing discussion: (1) We may begin by considering whether there has been a compelling trend in economic events which foretells a gradual decline of competitive markets and a corresponding increase in monopolistic conditions. (2) Next, we shall consider the effects of war influences on price making after the war. Has war introduced into the pattern of events factors so powerful as to break sharply historical continuity, so that what occurs after the war may bear scant relation to what has gone before? (3) Following this, it will be worth while to consider what general types of price control may develop in the aftermath of the present conflict, and what other controls are entailed by each such broad type of price regulation. (4) Certain broad economic and political

[1] The subject matter of this essay in certain respects relates to topics discussed by the author in "The Effect of the War on Price Policies and Price Making," *American Economic Review*, Supplement, Vol. XXXII (1942), pp. 404–415. The present essay, however, places considerably more emphasis on the types of price control which may be employed after the war and the problems which such controls entail.

consequences of adopting widespread control of commodity prices as a long-run policy will then be outlined. (5) And, finally, reference will be made to some factors in the postwar world which will influence the choice between those types of price control which government may undertake.

1. HAS THIS COUNTRY EXPERIENCED A TREND TOWARD MONOPOLISTIC PRICING

Over the past several decades a popular and widely accepted dogma has developed to the effect that economic markets are tending to become more and more monopolistic. As a corollary, competitive forces are assumed to be weakening in scope and effectiveness.

This view has often been expressed in a form which implies that once upon a time there was "free competition." Sometimes, and with less naïveté, it is presumed that free competition in a full sense never did exist, but that, nevertheless, a much closer approximation of it prevailed during portions of the nineteenth century than has been characteristic of, say, the last half century. "Proofs" have been advanced. Tables have been thrust upon us, showing that the number of ironworks, flour mills, and the like, has declined over the decades, while the total volume of output has grown apace. From such data of the decreasing number and increasing size of firms in various lines of manufacture, the decay of competition has been inferred. Likewise, writers have vividly portrayed the growth of large corporations and the devices by which the corporate form of organization has become the vehicle of monopoly.

Such studies are stimulating. But they are inadequate to the strain placed on them by those who wish to demonstrate the decline of competition. For competition and monopoly are concepts of the market, and their extent must be related to the dimensions of markets. In a period when avenues of transport and communication were being broadened in phenomenal degree, it was somehow assumed that the political boundaries of a nation were a measure of the geographic extent of a market. Moreover, while men wrote of technology as a force making for monopoly via large-scale production, they rarely mentioned technology as a force which tended also constantly to blur the boundaries separating particular "markets" and "commodities" from another.

We *know* only that divergent forces have been set in motion by an industrial revolution which has by no means run its course. During the same period in which technology, improvements in industrial management, and changes in the form and mores of law joined in facilitating large-scale production in all its aspects, similar changes were broadening the geographic areas within which men bought and sold and were increasing the possibilities of using one material, process, or finished good in displacement of another.

Perhaps competition has declined; perhaps it has increased. But certainly the dogma of its decline has been nowise demonstrated by our economic historians.[1] This is not important, save as the acceptance of the dogma has led many of us to assume that the modern world is in the grips of a technology which drives it inexorably toward an era of highly monopolistic markets in which government must resort to an ever more extensive control of price.

Unfortunately, we must view the future in this respect with little assistance from our study of the past.

2. THE INFLUENCE OF THE WAR ON PRICE MAKING

It is patent that the present conflict has set in motion forces which bid fair to remake both our thinking and our scheme of things economic. In a total war, when every resource must be marshaled ruthlessly to the end of physical combat, there is little place for the free operation of market forces.[2]

The forces at work in wartime are well known and it will suffice merely to refer to the chief among them.

a. Modern war involves an over-all reallocation of human and material resources between products and their uses.

b. Under the stimulus of dire necessity, war also brings rapid advances in technology with respect to both the techniques of production and the methods of utilizing new materials and combinations of materials.

c. Moreover, government controls of various sorts, including price control, proliferate to such a degree that we find ourselves possessed of a highly regimented economy.

[1] Rarely has the economic historian proved himself both an economist *and* an historian.

[2] This is true even though there is legitimate controversy as to the precise degree to which usual market influences must be replaced by government controls.

d. Even more significantly, perhaps, a flux takes place in men's ideas about the future organization of society. Urgently questioned are traditional views as to the role of the state, the desirability of various measures and degrees of control, and the place of individual responsibility in both economic and political affairs.

The impact of these wartime influences upon price making and governmental price control is both specific and general. Specifically, factors such as the three first mentioned above tend substantially to modify what may be referred to as the pattern of our economy, including particularly the structure of markets and the operation of market forces. More generally, the ferment of ideas challenges each preconception about things as they have been and creates a climate of thought out of which sweeping changes may come. (In this essay emphasis will be placed on the specific influences directly affecting the pattern of our economy, rather than on the general influences operating indirectly through changing ideas.)

Price making depends essentially on the competitive structure within particular industries (*i.e.*, on the number and relative size of firms in a given market); the strength of the barriers between "markets," "commodities," and "industries"; the competitive attitudes of firms (which we may term their "will to compete"); and the extent of direct price regulation by government.

The competitive structure within and between industries and markets is now undergoing rapid adjustment under the pressures engendered by shortages of materials and manpower in some areas and the expansion of capacities in others, and by developments in technology. Shortages of material bid fair to eliminate entirely certain enterprises, the nature of which precludes their change-over to war production. Moreover, revolutions in technology with respect to both industrial processes and the uses of materials are creating a situation in which many enterprises and industries will find their position materially changed when the fighting is over.

The effect of these basic factors—scarcity of resources and their consequent reallocation, expansion of productive capacities, and technological developments—is in considerable measure contingent upon the types of policy used by government in its regimentation of the economy for war purposes. Policies with respect to the allocation of orders and materials, geographical dispersion of plants, deliberate concentration of business in a few plants, conversion of facilities, man-power allocation, financing of plant expansion, and

many other phases of war planning are obviously of major significance. It would be incorrect, however, to assume that these influences operate only to decrease the competitive potential after the war. In transportation, for example, the impetus given by war to the development of air commerce may well create a far more competitive structure than has heretofore existed. The consequences of this change, moreover, may weaken the power of local and national monopolies. Likewise, experimentation in such areas as plastics and synthetic rubber may change altogether the prewar competitive structure in these and related industries. As we readjust ourselves to peace, we may find that areas such as steel and aluminum, once popular illustrations of monopolistic industries, present a far more fluid picture as a result of developments affecting the substitutability of materials.

Wartime price control, per se, need not alter the competitive structure of industry one way or the other, but it may do so. The influence of wartime price control in this direction depends largely on the policies employed. We may mention a few. Insofar as price control authorities, in relating prices to costs, follow a policy which leaves adequate provision and incentive for plant maintenance and replacement (within the limitation of available materials), the number and relative size of firms may not be affected by price control as such. Likewise, it makes a difference whether price authorities employ a bulk line as contrasted with a multiple or differential pricing system. The latter may permit more firms somehow to find their way through the depression of war than would an employment of a single price policy which refused to recognize the necessities of marginal plants and enterprises. Conversely, the rigid maintenance of a price freeze with no provision for adjustments therefrom, save in the case of military supplies, would obviously result in a much greater mortality of firms than would ensue from materials shortages only.

So far as the competitive attitude of industry, or the "will to compete," is concerned, the forces at work during war should have their consequences largely after the fighting is over rather than during the course of the conflict. In the immediate postwar period, we are apt to encounter two general types of situations. Some enterprises may be in a comparatively happy situation of booming markets in commodities where demand during war had to be choked off for reasons of conservation. In such areas it is difficult to imagine any widespread movement toward monopoliza-

tion whether by conspiracy, gentlemen's agreement, or otherwise. In less fortunate areas, however, production during the war is being raised to levels never before equaled. Basic materials of war are being turned out in such volume that only a supreme optimist could conceive of postwar years which did not bring deflation in certain of these industries. In such circumstances the "will to compete" may well be replaced by desperate efforts to control supply and thereby to maintain prices.

Some would say that controls such as price regulation now developing in wartime will become so entrenched that their continuance when peace is established is more than likely. The strength of this argument clearly increases as the length of the war is prolonged. The result is unlikely, however, if we assume a war short enough that controls continue to be regarded as "emergency" in character and our frame of reference remains one in which the presence of the direct price controls now developing is regarded as "abnormal."

The above may be summarized by stating that price making after the war, so far as the specific influences during the period of conflict are concerned, will depend on the extent to which the competitive structure within industries and markets, the barriers between rival goods, markets, and industries, and the competitive attitudes of firms have been altered, and on whether wartime price controls have had an opportunity to become habitual. Wartime price control, as such, may well have much less effect upon the outcome than results from materials shortages, expansion of the capacities to produce war materials, and technological change. Whether wartime influences will operate sharply to break the continuity of development of our economic organization cannot be predicted by reciting the above and related factors. One can only express the opinion that the forces at work are to a great extent divergent in their consequences and, further, offer the commonplace observation that the longer the war lasts the more difficult and improbable will be a return to the semicompetitive economy in which once we lived.

3. TYPES OF POSTWAR PRICE CONTROL

The postwar situation may be viewed from either an immediate or a long-run point of view. Clearly, the types of price control that may continue for a short while are considerably different in character and purpose from those which would necessarily develop

if the United States chooses to employ direct price regulation as a continuing policy.

The immediate postwar situation will certainly be one in which the inflationary potential is very great indeed. Consequently, many will favor the continuance of maximum price regulations, particularly in the areas of consumers' goods and services, as a means of preventing a severe inflation of costs of living.[1]

A brief continuance of emergency regulations along these lines may well occur. Their longer retention, however, will be handicapped by the fact that the support for such controls will be politically anonymous and disorganized rather than coming from powerfully organized groups.[2] Effective political support is more likely to be given to requests for minimum price regulations to protect industries and areas confronted with surpluses of capacity and inventory inherited from the years of conflict.

Either type of *temporary* control, be it the establishment of maximum or of minimum prices, should prove to be considerably more difficult to administer during the immediate postwar years than is maximum price control during the war itself. The widespread popular support that is marshaled during wartime will be absent. Such temporary postwar control, if it is to be successful, will require an insight into changing supply and demand situations more difficult to predict than those encountered by price regulation during the period of conflict. Moreover, it will be essential that somehow or other such control be so administered as to facilitate its own termination. This will require a high degree of flexibility and the use of somewhat different criteria than prevailed during the war.

If national policy develops along the lines of the *enduring* regulation of commodity prices, certain developments in control will necessarily occur which can be largely avoided in the case of emergency regulation. Emergency control must content itself with highly approximate results. Moreover, it is assisted by the existence of a situation in which economic interests are less controlling of business decisions than in peacetime. Likewise, continuing control must be prepared to meet problems of long-run economic

[1] Just as after the First World War, the emergency price control that was continued the longest was that of rent.

[2] Unless American labor by that time comes to have a greater and more realistic appreciation of the consequences to it of price inflation than it has shown thus far during the war.

adjustment which can be largely ignored during war. To illustrate: the Office of Price Administration finds it neither possible nor necessary to determine with decimal-point accuracy the economically necessary level of earnings in the case of each product of each industry. It can and must content itself with rough approximations. In doing so, if price ceilings are set which create a situation in which the production of commodity *A* is slightly less profitable than the production of commodity *B*, it does not necessarily follow that production will reflect the comparative profit margins of the two commodities in question. To a certain extent business firms will continue to guide relative production on the basis of their appraisal of the long-run importance of the markets for products *A* and *B*, regarding the war as a temporary situation. To a certain extent, also, if commodity *A* is more necessary for war purposes, firms may continue to produce it as a matter of patriotic obligation. Price control, furthermore, is assisted by the allocation of scarce materials and perhaps man power, so that firms may not be free to exploit the higher net margin available on commodity *B*. Were price regulation a continuing policy in peacetime, such difficulties as these, which can be minimized in time of war and in the shorter run, would become problems of paramount importance. To operate successfully during peacetime, price control necessarily would have drastically to reformulate its procedures and criteria of action.

To discharge its long-run functions adequately, price regulation would have to be bolstered by a number of correlative controls over private finance, accounting, and the quality if not quantity of production of goods and services. Thus, such control must be most comprehensive, embracing virtually all the economy. One is reminded of the development of rate regulation in transportation and public utilities. Begun with limited objectives and methods, control in these areas has extended both vertically and horizontally. The successful regulation of railroad transportation was found to require control also of the rates charged by other means of transport. Likewise, adequate control of rates was discovered to require control also of accounting methods, company finance, company expenditures for certain items, intercorporate relationships, and the quality and quantity of services rendered.

There is little reason to suppose that this record would not be duplicated in substance in the commodity areas where wartime controls are now functioning. In fact, controls would probably have to become much more extensive, with respect to costs of labor

and materials, than has proved necessary in the field of transportation and public utilities. With certain minor exceptions it has not been necessary for the Interstate Commerce Commission to control the prices of materials and services purchased by railroads. Likewise, while wage rates have been subject to compulsory mediation, they have not been under direct government regulation. In each of these cases, the ability of railroad regulation to limit its scope lay in the existence of other unregulated areas within which wage rates and materials prices were broadly determined by market forces. If, however, commodity price control covers substantially the whole economy, costs can scarcely be left to the determination of nongovernmental forces.

It seems conservative to predict that general control of commodity prices could not be made effective without full regulation of both wage rates and cost prices of industrial materials and services. Indeed, it might well be necessary also to accompany the control of costs and prices with the direct allocation of productive resources.

The essential correctness of this view has been indicated even during the short period of wartime price control which has thus far transpired. Our war experience is demonstrating not only the intimate interdependence of all costs and prices, but also the inability of either price or allocation policies to function adequately without the other.

4. THE CONSEQUENCES OF POSTWAR POLICY OF PRICE REGULATION

During the years immediately following the war, the economy of the United States will be at the crossroads. The issue is not in any sense whether government will intervene largely in economic affairs; the only question is the character of government intervention. (*a*) An attempt may be made to return to approximately the same general lines of policy followed before the war; (*b*) alternatively, the choice may be to follow a course of widespread general commodity price regulation, including perhaps the allocation of human and material resources among various industries and products; or (*c*) an effort may be made to secure a maximum degree of competitive controls in the market place, accompanying this policy with certain other measures designed to create a higher level of social well-being and stability than we have had heretofore.

a. It is necessary to refer only briefly to things as they were. Before the war our economic policy was a strange complex of conflicting ends and conflicting means. On the one hand, a reinvigor-

ated antitrust policy was endeavoring to foster competition. At the same time, various measures in areas of retail prices, interstate trade relations, agriculture, and labor were designed to foster what were essentially monopolistic conditions. We possessed an economy in which the most was made neither of individual and competitive forces nor of public control. The United States was in the throes of change, but the direction or purpose of change was anything but clear.

b. When peace comes this country may well embark on a permanent policy which includes the general regulation of commodity prices. As stated in the preceding section, such a policy may almost inevitably entail the regulation of all prices, including wages, industrial materials, and services, as well as such key phases of private business as the financing of enterprise, intercompany relationships, accounting methods, and the quality and quantity of goods produced. Perhaps, also, the allocation of materials and labor among different uses will be necessary.

Such a course poses economic and political questions of the utmost significance. *Economically,* private enterprise in such a system would be stripped of its functional justification. This justification is a familiar argument. A system of private enterprise is *economically* preferable to one of public ownership only if over the years it produces more for less. Its defense rests on the proposition that individuals and groups of individuals, left to their own devices, will do a better job in the course of the struggle for survival and success than would be done if the incentive to private initiative were absent. Yet, a combination of private "ownership" with a public control so pervasive that the key elements in business decisions are in public rather than private hands may well create a situation in which we have the evils of both systems with the advantages of neither.[1] This amounts to saying that the essential decisions of business center around prices and costs, including wage rates, and that, if full public control of those decisions is established, what remains of a system of private enterprise is but a shell, the retention of which is questionable. For such reasons the choice in the postwar years between continuing and widespread regulation

[1] In areas where price control has already had opportunity for substantial development, *e.g.*, in public utilities and transportation, where price control has been used for 50 years, this dilemma is well recognized. One body of opinion, consequently, has favored the establishment of competition through public ownership of rival plants. Another has favored abandoning this private ownership in favor of public enterprise.

of prices by government and the abolition of such controls, perhaps after a short transition period, is no less a question than that of the fundamental character of our future economy.

The political issue is equally basic: can a highly regimented economy be operated efficiently by a representative political democracy? The question can be expressed simply and perhaps more realistically by asking whether it is possible to operate an economic system through the medium of the ballot box. Few problems have been commented upon more often in recent economic and political literature than the danger to national unity and stability arising from the increasing power of economic groups. So long as farmers may gain at least in the short run by persuading government to legislate in their behalf, and so long as the same is true of industry, labor, and of virtually every group of individuals with common economic interests, it is difficult to see how a national government can at once operate an economy efficiently and at the same time answer at the polls to its constituents.

c. The above does not in any sense mean that important government action along economic lines is incompatible with political democracy as we have known it in this country. Many types of government policy, far reaching in their consequences, can be adopted without incurring the political results attendant upon government control of such matters as prices and wages. The United States has far to go before it will have established a real program of social security or created a situation in which there are not strong barriers between classes, which in many instances deny economic freedom to the individual. Moreover, we have scarcely made a beginning in the direction of achieving stable economic conditions through various measures that may well stop considerably short of a full regimentation of the economy.[1]

[1] Insofar as competition and monopoly are concerned, it cannot be argued that government policy—national, state, and local—has really attempted to foster competition and thus prevent the exploitation of the many by the few. Antitrust law enforcement has for the most part been an extracurricular activity in government over the past half century. Trade barriers between states have been permitted to grow alarmingly. Monopolies have been fostered by tariffs which check the competition of others who happen to live on the wrong side of political boundary lines. Government has sanctioned the fixing of retail prices. Where competition has existed, as in agriculture, and where monopoly could not well be achieved through private effort, government has hastened to create the essential conditions of monopoly. Even our laws governing entrance into the professions, including teaching, have been partially motivated by a

5. POSTWAR INFLUENCES ON WHICH THE DECISION MAY TURN

A number of influences will condition the choice among the types of economic policy outlined in the preceding section. Certainly it is possible to predict some of the more important of them. First, and foremost, the decision will turn on whether we have really won the war. If the United Nations achieve but partial victory, it will be necessary for this country to live as in an armed camp. If so, the fashioning of a military state will make it most difficult to achieve a system in which significant scope is left to private economic decisions. In other words, if the peace is but an armed truce, we may well expect a continuing policy of economic controls including price control. Likewise, if we win the physical combat but lose the peace through stupidity in providing for a postwar world in which nations have a practical opportunity to live in peace and security, then, also, we may find it necessary to continue an economy designed essentially for purposes of war rather than of peace.

A second and correlative factor is the character of international relationships that are established. One finds in the provisions of the Atlantic Charter a point of view which may free channels of trade throughout the world to an extent never before known. The widespread absence of artificial barriers to trade, coupled with the phenomenal revolution occurring in the technologies of transportation and communication, may well create a situation in which private monopolies have hard sledding indeed[1] (unless government chooses deliberately to encourage their formation).

A third conditioning factor is our ability to avoid a severe and prolonged depression.[2] Whatever may be the "economic merits of the case," it seems most unlikely that such a depression will be

desire to maintain monopolistically the fees and salaries of those in such occupations.

[1] It is interesting to speculate whether the lack of interest in antitrust legislation on the part of England during the period between the repeal of the Corn Laws and the doldrums of the 1920's was not due in large measure to the fact that industry in England was continually confronted by a substantial degree of competition consequent upon a policy of free trade.

[2] There are excellent reasons why it should not be assumed that such a depression will follow closely upon the coming of peace. World rehabilitation opens prospects of trade of substantial magnitude. The demands pent up during the war will likely act as a cushion to adjustment. It may well be that the passing of the American frontier so deplored by many students of business conditions will be replaced by new frontiers in South America and in Asia which will provide a continuing stimulus of great magnitude. The same influence, in

tolerated by the people of this nation. The paradox of full employment in wartime and continuing unemployment during peacetime is rather too painful for a leader or governing class to explain away. Whether or not a more collectivistic economy will in fact make people "happier" or provide for them a more abundant life, still prolonged depression will create a popular demand to try something different.

And finally, whether the United States adopts a program of general price fixing as a long-run policy will depend in large measure on the ability of political leaders and voters to distinguish between the consequences of alternative types of economic policy, as well as upon their willingness to subordinate group interests to the larger good. Some may challenge the statement, but to the writer it seems established that the time has passed when the government will be permitted to follow a do-nothing policy. Our difficulties, however, arise in considerable degree from the seeming conviction among many that any sort of government action is about the same as any other in its implications. "Conservatives" still inveigh against each new government statute provided it is not merely the repeal of an earlier one, while "liberals" too often assume that, if an evil exists, a law declaring that it shall not exist will cure the matter.

The point is that certain types of government policy, such as those having to do with social security programs, public expenditures to maintain a minimum level of economic activity, and management of the credit and monetary structure, do not intervene so drastically in the functioning of private enterprise as do specific regulations aimed at the heart of business decisions, *i.e.*, controls of the prices of goods and services (including the services of labor). Controls of the latter type run a grave risk of reducing private enterprise to a system that, from a social point of view, is essentially functionless.

When the war is over the United States may employ commodity price regulation as a temporary expedient only, in which case the character of price regulation must change considerably from that developed during war itself. If, on the other hand, we choose to

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a shorter run, stems from a rehabilitation of Europe. Moreover, the potential investment opportunities resulting not merely from the shifting of industry from war to peacetime production but from the exploitation of great advances in technology here and elsewhere in the world will provide a potential capital goods market of significance for years to come.

establish the general regulation of commodity prices as a long-run policy, then certain results should be recognized at the outset. Such control, if it is to be employed at all, may necessarily become so comprehensive as to include the fixing of virtually all prices, including the wages of labor and the prices of industrial materials. It may well be necessary, also, to accompany price control with governmental allocations of industrial materials and labor.

The consequences of such a policy, as a long-run proposition, are of the greatest import both economically and politically. Under so complete a system of controls, private ownership will have become a mere fiction shorn of its functional significance. Thus, the adoption of price control as a general and "permanent" policy amounts to the choice of a basically different type of economic system than that which we have had.

A number of factors—political, economic, and social—will condition the choice between fundamentally different avenues of policy. Among others, the factors that will influence the choice include the degree of victory by the United Nations, the character of international economic relationships established after the war, the ability of the United States to avoid severe and prolonged depression, and the intelligence of the leaders and voters of this country in distinguishing between the consequences of different types of economic policy.

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