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CAN THE GOVERNMENT PREVENT AN ECONOMIC DEPRESSION?

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CAN THE GOVERNMENT PREVENT AN ECONOMIC DEPRESSION?

Introduction

"Depression is not a matter of incidental abuses, but of an economic system failing in its main task, of energizing production. It calls, not for piecemeal reforms, but for comprehensive treatment of an organic malady, ramifying throughout the economic system."[1] From the time of Malthus and his concern over "general gluts" up to the present day, economists have been troubled over that phase of the business cycle known as depression. In order to understand this term, it is necessary first to comprehend the meaning of the term "business cycle." According to Wesley C. Mitchell, the business cycle is a "type of fluctuation characteristic of economic activities organized in the form of 'business economy' or 'high capitalism.'"[2] This fluctuation causes unbalance, either in an upward or downward direction, and these general ups and downs have a certain regularity, the periodicity of a major cycle being about ten years with approximately three minor cycles to a decade. Prior to the Great Depression (1929-1937), the shortest cycle lasted about two years and the longest about five years, with every third cycle being more severe than the others, thus giving evidence of a major cycle of about ten years in length.[3]

Depression, then, is one of the phases of the business cycle, the others being generally recognized as the upswing, the boom or prosperity, and the downswing or decline. For years before the Great Depression, declines and depressions had been characteristic of the American economy. David Lynch calls depression "one of the most 'normal' attributes of the system behaving in an 'abnormal' manner."[4] These disorders apparently are more common and

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1 John Maurice Clark, Social Control of Business, McGraw-Hill Book Company, New York, 1939, p. ix.
2 Wesley C. Mitchell, "Business Cycles," Encyclopedia of the Social Sciences, Vol. III, p. 92. Cf. Marshall Edward Dimock, Business and Government, Henry Holt and Company, New York, 1953, p. 677.
3 Clark, op. cit., p. 406.
4 David Lynch, The Concentration of Economic Power, Columbia University Press, New York, 1946, p. 239.

more severe in wealthy economies, such as America, than elsewhere. Keynes calls it "the paradox of poverty and potential plenty." He attributes it to the fact that the gap between income and consumption is very large in a wealthy community, so much so that a community will have difficulty finding investment outlets adequate to make up the difference. If these outlets are not sufficient, full employment cannot be maintained because actual output will necessarily drop until it equals consumption plus actual investment.[1]

In modern terminology, the word "depression" has been more clearly and precisely defined. The process of decline and depression is thought of as being in three categories. "Readjustment," the first stage, represents a fall in industrial production from zero per cent to 15 per cent and lasts not longer than a year. It may be of two kinds, "general" when the whole economy is affected, or "limited" when only a few industries feel a decline. The second stage, "recession," represents a fall from 15 per cent to 33 per cent from the peak and lasts from one year to eighteen months. A fall in industrial production of more than 33 per cent defines the final stage as "depression." To be considered a "depression," the slump must also last at least eighteen months.[2]

The problem of depression is, in other words, the problem of unemployment. If such a problem threatens the United States today, can the Federal Government act to dispel it? Should the Government act? If so, when and how? It is to these questions that I address myself in this exposition.

Theories of Depression

What causes depressions? The search for the answer has been deep and thorough and long, and the results have been varied, some shallow and naive,

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1 Dudley Dillard, The Economics of John Maynard Keynes, Prentice-Hall, Inc., New York, 1948, p. 55.

2 J. A. Livingston, "Business Outlook," Greensboro Daily News, October 18, 1953, Sports Section, p. 9, Col. 5.

some sweeping and exhaustive. Here, I shall consider only the major theories which relate to the subject.[1]

One of the oldest theories is the weather theory. The most prominent of the weather theories is the Sunspot theory advanced by W. S. Jevons. He claimed that variations in the atmosphere of the sun determine the rhythmical fluctuations of industry, and he did find the average cycle of sunspots of 10.45 years to coincide with the average length of the English trade cycle of 10.5 years. According to his belief, sunspots affect the weather; the weather affects agriculture; and agriculture affects industry and commerce. When a change in the average length of the sunspots cycle was accepted by authorities (from 10.45 years to 11-13 years), and when a change also occurred in the intervals between economic crises, Jevon' theory seemed paralogical and invalid. His son, H. S. Jevons, tried to rescue it by finding a correlation between a $3\frac{1}{2}$ year cycle in solar radiation and barometric pressure and a $3\frac{1}{2}$ year cycle of crop yields. Correspondingly, he found a tendency for trade cycles to move in seven or ten year intervals. From this he concluded that two or three cycles of crops were needed to bring about a trade cycle. This theory is considered to be somewhat groundless, and today little is heard of it.

The basic assumption in Schumpeter' s Innovation theory is that the economic system is in a state of equilibrium before innovations take place in which all factors of production are fully employed and entrepreneurs are making zero profits. Innovations, the creation of something new, such as a new method, a new commodity, or a new market, disturb this equilibrium and cause an enlarged demand for capital goods. These innovations come

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1 The sources for the following summary of the major theories, with the exception of the discussion on Keynes, are:
James A rthur Estey, Business Cycles, Prentice-Hall, Inc., New York, 1950, pp. 155-287.
Gottfried Von Haberler, Prosperity and Depression, League of Nations, Geneva, 1937, pp. 5-142.

in waves, and these waves of expansion are financed by bank credit; and this credit in the hands of innovators allows them to draw the productive resources away from the less fortunate by outbidding them in price, thus causing a price rise. Additional expenditures by entrepreneurs add to receipts of producers of capital goods. Wages will rise and thus increase demand for consumer's goods, but output of consumers' goods will fall since the factors of production are being drawn into production of capital equipment. Therefore, consumer prices will rise. All of this results in profits for everybody.

The turning point of this expansion period comes when the increased output of consumers' goods hits the market. When the period of gestation is over, the level of output will be much higher than before the innovation. Even though a fall in prices has been accounted for by the innovators subsequent to the rise in output, the increased output will still put pressure on the factors of production, costs rise, and profits again become zero. The end of expansion necessitates the adjustment of the economic system to the new levels of costs and prices and the new methods of production. Depression is this adjustment period. To Schumpeter, progress <u>is</u> fluctuation. Booms cause depressions; and these booms and depressions are the way a progressive, dynamic society adapts itself to technological change. No one could deny that innovations do affect the economic system; and, today, Schumpeter's theory is generally accepted as one of the outstanding explanations of the business cycle.

Cassel, like Schumpeter, thinks cycles are essential to progress. In his Overinvestment theory, he claims that forces of progress--innovations, opening of new countries, population growth--are the moving causes of the business cycle. At the beginning of the upswing, the rate of interest must

be low so that opportunities which start expansion offer excellent prospects for profit. This induces businessmen to plan on a large scale; and, since such planning is not commonly financed by banks, it calls for issues of securities. This expansion limits the growth of savings by the relative rise of wages over profits, because wage-earners save least and profit-makers most of all classes of society. This leads to overproduction relative to the volume of saving.

The crisis is felt first in the capital goods industries. The rise in the interest rate causes a falling price for the instruments of production. When fixed capital is ready for sale, it must be paid for by those who ordered it. Especially when the long-term projects are complete is there a strain on the capital market.[1] Producers have trouble selling the capital goods. When this happens, enterprises are abandoned and banks stop lending. Cassel's conclusion, then, is that " we save too little; we spend too much."[2] A pace in the production of capital goods is set that cannot be maintained because of undersupply of saving, not because of overproduction of goods.

According to Spiethoff, the crisis is caused by a shortage of capital, not simply a shortage of monetary funds but a disproportion of certain types of goods. There is a shortage and a plenty at the same time. The shortage is in labor and consumers' goods. The overproduction is in durable goods. New methods of production facilitate an increase in supply. Because there is a long interval between beginning construction and the time the product hits the market, the increased supply is faced with a constant or falling demand resulting from a lack of capital seeking investment. In other

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1 Evidently, Cassel assumes that businessmen order " machine tools" lacking funds with which to pay, or that producers of capital goods make them before receiving orders for them.

2 Estey, op. cit., p. 168.

words, the allocation of the factors of production to the various stages of production does not correspond to the flow of money. Capital formation is extremely important in the economy. History proves that the greatest fluctuations in depressions have been in the capital goods industries. This apparently corroborates to a great extent the claim of the Overinvestment school--that expansion leads to overinvestment, overinvestment leads to overproduction in the capital goods industries, and this spreads to other fields.

Underconsumption theories are numerous, some artless and groundless, others competent and comprehensive. One crude theory claims that the economic system cannot distribute enough purchasing power to enable the output of industry to be sold at a price covering costs, including a reasonable profit. Another theory contends that there is a secular trend for the volume of production to grow. Population increases, inventions raise output, and additions are made to capital stock. Unless the quantity of money increases to create purchasing power to absorb the increase in output at stable prices, depression will result when commodity prices fall. Still another theory claims that the end of the boom comes when goods from new processes begin to emerge.

One of the leading underconsumption theories is that of J. A. Hobson. Unlike others, he believes the costs of production that are paid out in wages and so forth are sufficient to buy the whole product of industry. He also believes that society can adjust to some saving. Undue saving, though, leads to overinvestment in the means of production so as to make the supply of consumers' goods greater than can be purchased at profitable prices. Contrary to the opinion of the overinvestment school, he asserts that voluntary saving can be and is necessarily excessive. The reason is the distribution of wealth. The incomes of the poor and the rich are not spent to the same degree; the poor

spend most or all of their income while the rich save a greater percentage of theirs. The bulk of savings comes from the high income groups and the percentage saved increases with an increase in income. As a consequence to this saving, productive facilities are increased. This makes business more active and leads to an expansion of bank credit and later to a price rise. Out of this expansion, further expansions of saving take place. But the increase to total income is not evenly distributed; wages lag in prosperity. Additions to higher incomes lead to more saving and investing. Since the "propensity to consume" is very inelastic, the volume of consumption is very small relative to the increased total income. This expansion leads to overproduction. When the goods hit the market, they cannot be consumed. In simple form, Hobson's theory is this: oversaving leads to overinvesting which, in turn, leads to overproduction relative to the volume of consumption which is much too small.

New meaning was cast on the underconsumption school, and the whole of economic theory as well, by the revolutionary thinking of John Maynard Keynes. In its simplest terms, Keynes' theory declares that "employment depends on investment."[1] Before investigating this causal factor, it is necessary to understand Keynes' terminology. Investment is not buying bonds and securities; it is the "addition to the existing stock of real capital assets."[2] It includes additions to inventories as well as to fixed capital. Saving is the "excess of income over consumption expenditure."[3] To Keynes, aggregate investment always equals aggregate saving. He arrives at this conclusion through the following line of thought. Employment results in the output of goods on one hand and the creation of income on the other. Thus, total output equals total income. Total income is equal to the income from consumers' output plus the income from investment. Saving is equal to the excess of income over consumption

1 Dillard, op. cit., p. 8.
2 Ibid., p. 60.
3 Ibid., p. 61.

expenditure. Therefore, investment must equal saving.[1]

In summary form, Keynes' theory is as follows. Income depends on employment; employment depends on effective demand; effective demand depends on the propensity to consume and the inducement to invest. Since the propensity to consume is relatively stable, effective demand depends mainly on investment; investment depends on the marginal efficiency of capital and the rate of interest; the marginal efficiency of capital depends on the expectations of profit yields and the replacement cost of capital assets; the rate of interest depends on the quantity of money and the state of liquidity preference.[2] A rise in the marginal efficiency of capital causes investment to increase, but it may be offset by a rise in the interest rate. Likewise, an increase in the quantity of money may be offset by a rise in the interest rate. Moreover, employment need not rise when investment is increasing if the propensity to consume is falling. A fall in investment means a decrease in income, which leads to a decrease in consumption, which leads to further decreases in income.[3]

Some theorists find the cause of depression solely in the monetary system. According to Hawtrey, in equilibrium consumers' outlay equals consumers' income; consumption equals production; and cash balances and neither increased nor diminished. The upswing is brought about by credit expansion. By reducing the interest rates, banks ease conditions under which loans are made. When banks lend and merchants and producers increase their expenditures, consumers' income rises. This is likely to increase consumers' outlay and set up cumulative consequences in which more cash is released by banks and businessmen. The general price level rises; and, because of a lag in wages and interest, profits are increased and businessmen borrow still further. It becomes less advantageous to hold cash balances--people want more in their pockets--and an increase in

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1 Ibid., p. 65.
2 Ibid., pp. 48-50.
3 Ibid., p. 51.

the velocity of circulation of the money supply takes place. The crisis comes when increased income and outlay of consumers cause a drain of cash out of banks. This flow of cash out of the banks when deposits, through loans, have been increasing puts pressure on bank reserves and they must stop lending. This drain of cash starts the downswing. Dealers are discouraged from investment; orders are reduced; wages fall; demand for goods collapses. Hawtrey contends that discount policy and open-market operations may be trusted to bring about the revival. To him, appropriate banking policy could remove business cycles. While it is true that banks play an important role, it cannot be concluded that this theory in itself is an adequate explanation of depressions.

The Psychological theory is not really a theory of causation, but rather is advanced as a supplement to other economic theories. The psychological factor is a change in expectations, attitudes, and thinking. In order to produce for tomorrow, there must be planning for the future. These estimates naturally involve an element of chance, since the future cannot be forecast with absolute precision.

Optimism and pessimism are attributes of the cycle. For example, in a period of rising demand and production, a producer in a branch of industry that has not yet felt the increase is inclined to expect one. Optimism and pessimism come in waves, for optimism in one sector leads to optimism in others, and the same is true of pessimism. Rather than being causes, then, psychological factors are intensifying elements.

It can be concluded from the above discussion that various theorists hold views which oppose each other. For example, some affirm the necessity of cycles in a dynamic society while a few declare that cycles can be avoided.

Others are doubtful whether declines can be completely avoided but believe that depressions can be mitigated. Again, some find the cause in too much saving; others claim that too little is saved. Nevertheless, they do agree on some points. While they may differ as to the cause of the crisis, they generally concur in their inference that the crisis takes place in the capital goods industries. Capital formation, then, is the clue. Likewise, the theorists are in accord when they describe the upswings and downswings as being cumulative. Once a shift commences, the acceleration priciple works to intensify it.

The Great Depression

So far, the discussion has been concerned with depression in general. Attention turns now to one particular depression, the Great Depression of the 1930's. Chester W. Wright traces the Depression back to World War I. From it, the American economy inherited certain maladjustments in cost-price relationships.[1] In the period 1920-21, there was a drastic fall in prices, but the general level was still twice as high as the prewar level. Wages were very high; and, since productivity had not risen, this meant a maladjustment between costs and prices. Manufacturing suffered for a while, but through technological improvements and restriction of production, it soon operated in the black. In residential construction, there was a postwar boom. Agriculture was the sickest industry. A continuing high production faced a fall in farm prices.

The period from 1922-29 evidenced a general rise in prosperity. Everyone thought eternal prosperity was here to stay. Even though materials and wage costs were high, the interest rate remained low enough to stimulate expansion in the building industry. The rapid growth of saving and loan

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1 Chester Whitney Wright, Economic History of the United States, McGraw-Hill Book Company, New York, 1949, p. 770.

associations and the development of markets for real-estate mortgage bonds facilitated new construction. In manufacturing, better methods of production increased productivity to offset the high wage rates. Reduced federal taxes, low interest rates, and high protective tariffs meant bigger profits for some industries. Concentration of financial control helped to stabilize some industries, but the rigid prices which resulted only meant trouble later on. Electric light and power utilities experienced a rapid expansion period. There was a large demand for services; and innovations cut costs, which precipitated an even larger volume of demand. Nevertheless, agriculture remained the sick branch of the economy. Costs failed to drop along with prices. Surpluses had to be sold in declining world markets; yet, the farmers continued to increase their production.[1]

The crisis in the years 1929-33 was, to say the least, unexpected. The slow decline of the price level had not been heeded. The top-heavy pyramiding of utilities had not been considered dangerous. No attention had been given to the sky-rocketing of the stock market. Banks had seen no need to curtail loans. The stock market crash was the first conspicuous event leading to the depression. Banks failed, properties were foreclosed, enterprises closed, unemployment increased. The impact permeated the world. Exports decreased and many countries had to go off the gold standard and devalue their currencies. World prices dropped; manufacturing output of industrial countries dropped 30-50 per cent.[2] The United States was affected more than most countries.[3] In employment, 43 million man-years were lost

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1 Ibid., pp. 771-777. The foregoing summary of conditions up to 1929 was taken from Wright's account.

2 Ibid., p. 779.

3 The following statistics are taken from:
Temporary National Economic Committee, Hearings, Part I, pp. 12-70.
Cf. Dimock, op. cit., p. 680.

between 1929-1938. American workers lost $120 billion in wages and salaries from 1929 to 1939. In the same period, $20 billion in profits was lost to owners of industry, and $38 billion in income was lost to farmers. To give an example of the cumulative effects that a decline generates, the following statistics are offered. "In the period from 1929 to 1932, national income fell from $83 billion to $40 billion; salaries and wages dropped from $49.2 billion to $29.9 billion; dividend payments from $6 billion to $2.7 billion; and farm income from $12 billion to $5.3 billion.... Unemployment rose from 13 million to 15 million."[1]

Few steps were taken to cure or even mitigate the depression before Franklin D. Roosevelt took office as President in March, 1933. Hoover did initiate several minor measures, such as supporting some agriculture prices, creating the Reconstruction Finance Corporation, and introducing the principle of deficit spending.[2] The New Deal objectives were generally these:[3]

1. Improving monetary and banking system--devaluing the dollar, offering cheap credit, insuring bank deposits.
2. Helping the farmer--improving farm methods, raising and stabilizing prices of farm products, strengthening of co-operative marketing.
3. Helping the laborer--work relief programs, Social Security program, wage and hour control, encouragement of collective bargaining.
4. Helping the businessman--National Recovery Administration calling for self-government of business by trade associations and maintenance of fair labor standards.
5. Helping the consumer--holding company control to prevent pyramiding, monopoly, and consumer exploitation in public utility field; control

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1 TNEC, Hearings, Part I, pp. 194, 201. Cf. Dimock, op. cit., p. 681.
2 Dimock, op. cit., p. 706.
3 Wright, op. cit., p. 782. and Dinock, op. cit. pp. 708-709.

of security issues; anti-trust enforcement; protection against false advertising.

6. Pump Priming--large public works and regional development programs.

It must not be concluded that the actual program of the New Deal was as clear and precise as the foregoing objectives indicate. Often, while one phase of the program tended toward adjustment, another had the opposite effect. Some reforms, though desirable, were not timely. It is doubtful that the monetary measures achieved their purpose. The important move the Government made in the field of monetary matters was to go off the full gold standard and devalue the dollar by 41 per cent. By doing this, it hoped to ease the burden of debtors and to boost prices; and it expected to stimulate international trade.[1] The latter objective was more fully realized than the former; domestic prices rose very little, but the cheaper dollars in foreign exchange provided a stimulus for American exports until other countries devalued their currencies. Accompanying this move was the Silver Purchasing Act of 1934, the purpose of which was to appreciate the value of that metal in exchange so that purchases from the United States would be stimulated. In effect, this practice did not help the foreign countries, but only hindered them.[2]

The efforts to alleviate the condition of the farmer emerged in the Agricultural Adjustment Act of 1933. Under this act, farmers were provided with cash income (benefit) payments, financed directly out of public funds but indirectly out of "processing" taxes levied on the processors. These payments were conditioned on the farmers' compliance with production control plans.[3] This act was later declared unconstitutional, and then the benefit

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1 Clark, op. cit., pp. 430-431.
2 Ibid.
3 Leverett S. Lyon and Victor Abramson, Government and Economic Life, Brookings Institution, Washington, 1940, pp. 913-914.

payments were tied to the soil conservation program and paid out of general revenues.[1] The main goal of agriculture reform was to raise prices. To do this, the "parity price" idea was adopted.[2] Along with this, reforms aimed at giving more support to marketing organizations, offering loans to farmers at low rates of interest, establishing an "ever-normal granary,"[3] and conserving some lands and taking out of cultivation those too poor to provide a living for the occupants. Such a program is generally condoned as an emergency measure but is condemned as a permanent fixture in the economy. "There is too much of a tendency to stress higher prices and ignore the volume of output as essential to the farmers' prosperity."[4]

One of the purposes of the National Industrial Recovery Act of 1933 was to initiate reforms in favor of labor. More than anything else, labor wanted assurance that collective bargaining and the right to organize would be respected. This provision was incorporated in Section 7A of the NRA. After the NRA was declared invalid, labor's objectives were again realized in the National Labor Relations Act of 1935. Along with recognizing labor's right to bargain collectively, it listed unfair practices of employers and set up a National Labor Relations Board to hear cases and to provide for elections to determine the proper bargaining agent. Later, a federal wage-and-hour act was passed. That labor reforms were highly desirable is not doubted, but whether or not they were timed properly is another question. Many claim that reforms should be initiated in the upswing rather than in the depth of a depression, for higher wages would cause even worse maladjustments.

In addition to these reforms, labor was aided by the passage of the Social Security Act, which provides for public assistance, old age and survivor's

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1 Clark, op. cit., p. 444.
2 Parity prices are discussed more fully on page 29.
3 The building of reserves in surplus years and working them off in years of shortage.
4 Wright, op. cit., p. 786.

insurance, and unemployment insurance. Reserves are built up by means of payroll taxes to provide for future payments. Clark declares that "this act, whatever changes may be found necessary in its specific provisions, may take rank as the soundest in principle and the most enduring contribution of the New Deal to our economic structure."[1]

The idea of pump priming and public works was mainly that of John Maynard Keynes. From his theory he showed the necessity of high rates of consumption and investment and used this as a basis for advocating public works, deficit spending, and steeply progressive taxation. In simple terms, the meaning of his multiplier is that government spending on public works in times of depression will increase national income not only by the actual amount of money spent but by some multiple of it.[2] It was this idea that the United States Government adopted and tried to put into practice. The program took two forms. The Public Works Administration started out with an appropriation under the NRA. PWA emphasized heavy construction work of a self-liquidating type. The work was slow and the major cost was for materials. Never did the PWA employ more than 171,000 workers at one time; yet, it spent almost one half of the entire public works appropriations from 1935-1940. On the other hand, the Works Progress Administration concentrated on short-term projects using many workers and cheap materials. Whereas PWA supplied jobs to small numbers in relation to need, the WPA averaged over two million on its payrolls.[3] Few would deny that the projects, such as constructing highways and building schools, airports, and public buildings, undertaken by these two agencies were of permanent value to America as a whole. They provided a market for

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1 Clark, op. cit., p. 442.
2 Dillard, op. cit., p. 53.
3 Dimock, op. cit., p. 719.

labor as well as the products of industry and agriculture.

To carry out this program of public works, relief work, and outright relief, the Government embarked on the practice of deficit spending. Of course, a pay-as-you-go plan is more desirable, but there are times when borrowing seems justified. The Government wanted to get money into circulation and to spend it so that the purchasing power created would multiply. This could not have been done within current revenues, and taxing the people more heavily would have merely taken money out of circulation. The course followed was deficit financing.

Did the New Deal accomplish what it set out to do, to pull the country out of the depths of the Great Depression? Many think it did, but that it betrayed liberalism in doing so. Others think that only World War II put America back on the road to prosperity. George Galloway summarizes briefly the pros and cons of the New Deal in the following manner.[1]

Assets:

1. The activities of the CCC, FSA, and WPA accomplished much in the way of conserving soil, water resources, wild-life, and forests.
2. Economic activity had been stimulated through loans to farmers, homeowners, and businessmen and through pump-priming expenditures for public works.
3. It raised labor standards through eliminating child labor, legalizing collective bargaining, and by minimum-wage and maximum-hour provisions of the Fair Labor Standards Law.
4. It increased the security of the population through arrangements for old-age assistance and pensions, for unemployment compensation, and for the clearance of slums and the erection of low-cost dwellings.

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1 George B. Galloway, Planning for America, Henry Holt and Company, New York, 1941, pp. 47-48.

Liabilities:

1. Many schools of economic thought, each with its own opinion and theory, "muddled" the economics of the New Deal.
2. Its administration of certain programs was weak and incompetent.
3. Its policies have often been inconsistent, such as the trust-campaign and the NRA exemptions from the Sherman Act.
4. It was guilty of pressure-group politics and interest-group planning.

John M. Clark concludes that "the New Deal has done much to alleviate the burdens of depression for those who feel them most severely, both for the present and for the future. It afforded an initial stimulus to recovery, but its later effects on that score are doubtful, and its future effects contain some positive dangers. Whatever the fate of particular measures, it is an outstanding landmark in the struggle to secure an economic system which can justify itself by meeting the essential needs of the people who depend upon it."[1]

Where We Are Now

Using the foregoing historical facts as background, it is easily discernible that the American economy has climbed high on the ladder of prosperity from the depression days of the 1930's on up through World War II to the present time.[2] Gross National Product was $60 billion in 1933 compared with $360.1 billion in 1952. Personal consumption expenditures were $45 billion in 1933; and in 1952, they were $222 billion. Business spent approximately $2 billion on new plants and equipment in 1933 compared to $26 billion in the last year. Finally, employment in 1933 totaled 38 million including agricultural and nonagricultural employment and today the number fainfully employed is about 62 million.[3]

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1 Clark, op. cit., p. 453.
2 It must be noted that since 1933 there has been quite a rise in the price level. For example, the wholesale price index has risen from 40 to 110 (1947-49=100).
3 The above figures are taken from:
Federal Reserve Charts on Bank Credit, Money Rates, and Business, Board of Governors of the Federal Reserve System, April, 1953, pp. 74, 77, 68, 79.

The question is, "Where are we now?" Are we in the readjustment phase? There is no explicit answer, but there are indicators that show trends.[1] Evidences are that we have passed the peak.

In 1952, business spent $26.5 billion on new plants and equipment as compared to $27 billion being spent in 1953.[2] (See supplementary chart No. 1.) From chart No. 2, it is observed that declines in iron and steel, nonferrous metals, and motor vehicles and equipment account for a decline in the durable goods industries; but the difference is more than made up by an increase of expenditures in the nondurable goods industries, mining, and public utilities.

Even though expenditures on new plants and equipment will not reach the 1953 level, businessmen do expect 1954 to be the second best year. The past five years have shown tremendous advancement, (chart No. 3) and there is reason to expect investment in capital goods to continue (charts No. 4 and No. 5). From 1948-1952, business spent $115 billion on expansion and modernization: $52 billion of earnings was plowed back into business, and to this, $30 billion of depreciation reserves was added; $9 billion was borrowed from banks and $24 billion of bonds and stocks was sold.[3] Whereas in the past, capital goods expenditures have been for expansion; in the future, they will be more for modernizing existing plants (chart No. 6). Scientific research and improvements in modern technology will make this obligatory. The automobile industry needs to develop gas turbines and higher-compression engines. Low-iron taconite ores are in the plans of the iron and steel industry. More modern machines are needed for coal mining, and quick canning methods and packaging equipment are necessary to food industries. At any rate, the nation's

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1 My study of business indices was made in October and November, and the figures have not been revised.
2 "Capital Spending Continues to Climb," Business Week, No. 1230 (March 28, 1953), p. 34.
3 "How Much More Plant Expansion?" Business Week, No. 1230 (March 28, 1953), p. 141.

productive capacity is expected to have increased by 16 per cent by 1956.[1] Producers must have diversified products to compete in a tougher market. In all manufacturing, businessmen expect to spend $10.1 billion in expansion and modernization during 1954, and in all industry (excluding commercial) capital goods expenditures should be $20.7 billion (chart No. 5 and No. 7). If trouble comes, manufacturers expect to cut expenditures on plants and equipment by one third.[2] Depreciation allowances, the main way of financing this sort of expansion, will serve as a prop under capital spending if a decline does come. "Continuous expansion may not prevent a recession or cure one, but it will provide a firm cushion in time of stress."[3]

As far as the residential construction is concerned, 128,500 new houses were started in the peak month of the postwar boom. In November, the number per month was 86,900. (See charts No. 1 and No. 8.) Compared to $36.6 billion spent on new construction at the peak of the boom, $34.3 is now being spent. Larger down payments and scarcity and higher cost of mortgage money are making it more difficult to sell new houses. Therefore, builders are discouraged from starting new dwellings. The fact that fewer families are being formed also indicates a decline in housing starts. This has an adverse effect on the demand for consumers' durable goods such as kitchen appliances and household furnishings.[4]

The index of industrial production (1925-39 = 100) which includes the manufacture of durables, the manufacture of nondurables, and mining, has declined from 243 in the boom peak to 232 now (charts No. 1 and No. 9).

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1 "Industries' Plans for Capital Spending: Still on a Big Scale," Business Week, No. 1231 (April 4, 1953), p. 113.
2 Ibid., p. 120.
3 "Full Steam Ahead," Business Week, No. 1231 (April 4, 1953), p. 164.
4 "Outlook for Business Now," United States News and World Report, vol. 35 (August 7, 1953), p. 12.

At present, the index shows a drop which reflects especially the manufacturing of durable goods, such as automobiles, steel, and farm implements. Inventories are getting larger; factory stocks are at a high of $46.4 billion. This, along with the drop in industrial production, is a danger sign. New factory orders at the boom peak were $28.3 billion per month as compared to $22.4 billion now (chart No. 1), and factory shipments were $26.9 billion per month as compared to $24.9 now. This means that production is outrunning demand. Already, this has caused cutbacks and shutdowns in the farm implement industry, home appliance industry, and radio and television industries.[1]

Supply seems to be outrunning demand in the case of wholesale prices, for the wholesale price index has taken a dip from 116.5 at the peak to 111.0 now(1947-49 = 100). (See chart No. 1.) This index is important because it is a composite of the prices, one step removed from the consumer, of many industries: farm products, processed foods, chemicals, fuel and power and lighting materials, furniture, hides and skins, lumber, machinery and motive products, metals, nonmetallic minerals, pulp and paper, rubber, textiles, and tobacco.[2] Many workers are dependent on these industries for their livelihood, and price declines here may mean unemployment for some.

The cost of living index is at a new high of 115.2 (1947-49 =100). Since July 1952, apparel and food have decreased slightly in price; housing has increased steadily; and medical care, personal care, and transportation have increased. Even though retail prices are at their highest peak, people are still buying at a high rate. In 1953, $170 billion is being spent on retail sales compared to $164 billion for 1952.[3] Yet, at the same time, all

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1 "The End of the Boom Is Official," United States News and World Report, vol. 35 (November 13, 1953), p. 31.
2 "Monthly Business Statistics," Survey of Current Business, vol. 33 (September, 1953), pp. s-5, s-6.
3 "Business in 1953," Business Week, No. 1244 (July 4, 1953), p. 27.

retail trade has dipped 3 per cent from last February.[1] However, consumers have been spending more than normal on durable goods. If they cut down on such spending, the purchasing power might go into buying more nondurables. Some say consumers would spend it on more luxury in living. Others claim that it would be saved, and thus cause the ratio of saving to personal income and consumption to rise. Now, personal saving is about $20 billion, which is 8 per cent of disposable income (chart No. 10). This, to some economists, is too high. Moreover, a high rate of consumer spending may not necessarily indicate a high rate of activity in the manufacturing industries behind the scenes. Merchants may draw on their inventories, which would mean less call on the factories for output. (Such was the case in 1949.) Factories, in turn, would live on their stockrooms at the expense of their suppliers. This would kick back to the raw materials producers, and employment would begin to suffer all along the line.

Ordinarily, the cost of living index, being at its highest peak, would be a stabilizing factor; but, when compared with wages, it seems to present a cost-price maladjustment. Because of less overtime and shorter hours, income of wage earners declined in September and October even though hourly wage rates increased. Hourly earnings are at a new high of $1.78 per hour, but weekly earnings are $70.49 as compared with $72.14 for the peak.[2] High retail prices put a squeeze on those who are taking cuts in income. In addition, an increase in wage rates at a time when sales are slipping may mean higher costs, unless productivity increases to an equal degree or more.

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1 "End of the Boom Is Official," op. cit., p. 30.
2 Ibid.

Escalator clauses in wage contracts lead to rigidity in wages; and this, too, puts some producers in a pinch if the cost of living goes up while sales are leveling off or falling.

More businesses are failing in 1953 than in 1952. Failures in commercial service, construction, manufacturing and mining, retail trade, and wholesale trade in September, 1953, were 686 as compared to 539 for a year ago.[1] The liabilities of these failures are greater than a year ago, totaling $33,817,000 for September, 1953.[2] Business failures may simply mean that the less efficient are being weeded out. However, it may be an indication of a general slack in business activity, pointing to a decline in sales and profits. These failures not only affect adversely the failing businessmen and their employees, but their creditors as well. It is clear, then, that the impact may spread to many sectors of the economy.

In November, prices received by farmers dropped to a twelve-year low while cost of living expenses for families continued to rise (chart No. 11). The parity ratio of 99, for the month ending November 15, was the lowest since 1941. At the same time, the index of prices paid by farmers rose one third of one per cent.[3] The farm mortgage debt outstanding is $7.6 billion.[4] Farmers find themselves in a difficult situation when farm income declines while the prices the farmers pay are rising. A decline in farm income influences particularly the rural areas of the country; merchants who are dependent on farm trade see drops in sales and profits. Moreover, sales in the farm implement industry will decline further. Changes in agricultural production affect not only agriculture itself, but the people who earn their

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1 "Monthly Business Statistics," Survey of Current Business, vol, 33 (November, 1953), p. s-4.
2 Ibid.
3 "Farmer Outgo Rises, Income Continues Dip," Greensboro Daily News, December,1, 1953, Section 1, p. 1, Col. 8.
4 "Financial, Industrial and Commercial Statistics, United States," Federal Reserve Bulletin, vol. 39 (November, 1953), p. 1189.

living through transportation, processing, packaging, and merchandising the farm products.

In the field of finance, the position of the commercial bank is important. Unlike the days of the Great Depression, banks are now a stabilizing factor in the economy. The banks are holding mostly short-term government securities which serve as good collateral for loans from the Federal Reserve Banks, and are in a strong position to extend credit and follow an easy money policy if a decline does come. The summer of 1953 evidenced an easing of the money market. In June, the Federal Reserve went into the open market and purchased government securities, an action which put Federal Reserve holdings of government securities up to $25 billion for the first time in history.[1] The second step toward an easier money policy was the reduction in member bank cash reserve requirements.[2] In September, authorities took a third step to pump excess funds in the money market through purchases of government securities. This pushed excess reserves up to a daily average of $750 million and bank borrowings fell to an average of $500 million.[3] More excess reserves encourage banks to lend on easier credit terms. Lower interest rates are an inducement for businessmen to borrow. Whether businessmen will borrow or not is another thing, for they will not do so unless they can foresee a profit.

In general, trading in the securities market has been slower. Securities took a big dip in the summer of 1953, and since then have been recovering gradually. Fluctuations in the securities market are chiefly fluctuations in speculation. Various feelings are reflected in the stock market, such as the piling up of inventories in some industries and the drop in farm products.

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1 Monthly Letter on Economic Conditions Government Finance, The National City Bank of New York, New York, October, 1953, p. 111.
2 Ibid.
3 Ibid.

For example, the stock of Studebaker Corporation dropped 2¼ points when the company laid off some of its employees. These fluctuations in securities may be indicative of businessmen's expectations.

No account of the present condition of the economy would be adequate without a word about the fiscal policy of the United States Government. The estimated federal expenditures for the fiscal year 1954 were $78.6 billion, incurring a deficit of $9.9 billion.[1] Congress, in its last session, trimmed some of the expenditures so that the deficit is approximately $6 billion. Of this amount, about $51 billion is being spent on defense.[2] The fact that budget expenditures equal 26 per cent of national income illustrates the importance of Government in the economy.[3] To understand the economic impact of all Federal transactions, a picture of total receipts from and total payments to the public is necessary. Total receipts from the public include $68.7 billion for budget receipts, plus $9.6 billion for trust funds minus $3.0 billion for intragovernmental transactions minus $0.1 billion for seigniorage on silver, thus giving a total income of $75.2 billion. Total payments to the public include $78.6 billion for budget expenditures plus $6.3 billion for trust funds minus $3.0 billion for intragovernmental transactions minus $0.1 billion for net accrued interest and other noncash transactions, giving a total outgo of $81.8 billion. The net outgo of payments over receipts, then, is $6.6 billion.[4] A net outgo is, in itself, inflationary. However, because of budget cuts and because the mobilization goal is practically achieved, defense spending is showing a downward trend from $53.3 billion to $51.5 billion[5] and this tends to be anti-inflationary.

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1 The Federal Budget in Brief, Fiscal Year 1954, Executive Office of the President, Bureau of the Budget, p. 4.
2 The two preceding figures are estimates since exact figures on appropriations seem unavailable.
3 The Federal Budget in Brief..., op. cit., p. 37.
4 Ibid., p. 42. The foregoing statistics are based on the proposed 1954 budget.
5 "Trend of American Business," United States News and World Report, vol. 35 (October 30, 1953), p. 85.

Yet, defense spending is high and shall, of necessity, remain high. The Government pays people to manufacture goods they cannot consume. The money comes from taxes and borrowing, whereas if people kept it all, they would probably save some of it. Thus, more money is thrown into circulation.[1] This is one barrier against a deep depression. In connection with this, consideration must be given to the national debt, which is around $275 billion. It is generally quite desirable to have a balanced budget and pay as you go; but often, through the inflationary policy of borrowing from banks, the Government can pump money into the economy when it is greatly needed. With the debt as large as it is, proper management of it in times of stress may be of great value.

In summarizing, it can be said that the economy, as a whole, is strong. 1953 is the biggest boom year in the country's history. There seem to be no inherent maladies today as there were in the 1930's. Yet, the indicators point to a decline. We have passed the peak.

When Should the Government Act?

Before discussing the methods the Government could use to repel a decline, it is proper first to determine when the Government should act. Recalling the three phases of the downswing--readjustment, recession, and depression--it seems logical that the Government should not interfere in stage one, readjustment. Even if business activity does not continue upward but instead levels off, the Government should not step in. Arthur F. Burns, Chairman of the Council of Economic Advisers to the President, does not consider downturns like 1926-27 and 1948-49 crucial. He says the problem is

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1 Randolph Burgess: Interview, "Depression? No! Readjustment? Yes!" United States News and World Report, vol. 35 (December 4, 1953), p. 56.

not one of minor ups and downs, but of depression.[1] Many factors outside the business cycle itself, such as seasonal fluctuations and technological changes, can cause such ups and downs. Some instability is desirable in a dynamic economy, for nothing short of a "planned" economy could prevent instability.

Neither should the Government interfere if private enterprise itself succeeds in stabilizing the economy. Already, business has shown much success in palliating short-run fluctuations through devices such as scheduling vacations during slack periods, transferring employees from busy departments to slack ones, hiring part-time people at seasonal peaks, and producing for stock during slack seasons.[2] It is reasonable to assume, too, that it could be helpful in the longer-run. One way is through long-term planning for capital outlays. By planning towards less concentration of capital in boom periods and toward exploitation of the lower cost advantages in slack periods, business can add stability to investment and to business cycles in general.[3] This presents problems, of course, the problem of putting off expansion at a time when consumer demand is high and the problem of modernizing to keep up with competition as well as the problem of financing in recession periods.

As far as debt management is concerned, it is good for businesses if they can retire debt in prosperity and borrow in periods of decline.[4] Here, too, there is the problem that the facilities financed through such borrowing in slack periods may not be needed. Nevertheless, through increasing debt in bad times, business may be able to provide a helpful stimulus.

Again, better manipulation of inventories would be of value. Through

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1 "He's Watching for Trouble," Business Week, No. 1246 (July 18, 1953), p. 45.
2 A Program for Expanding Jobs and Production, Chamber of Commerce of the United States, Washington, 1953, p. 15.
3 Ibid., p. 16.
4 Ibid., p. 17.

refusing to build up speculative inventories, businessmen could prevent "inventory recessions" as the one in 1949,[1] Accumulating inventories in slack periods and letting them work off in active periods can do much to smooth this volatile item.

Since research is a long-term process, it cannot be stepped up quickly or reduced suddenly. Despite the fact that its use as a countercyclical device is limited, it is important in maintaining and stimulating business and consumer demand and consumption.[2] Through diversifying products, developing supplementary product lines, changing product mixes, strengthening merchandising, advertising, and selling programs, and seeking new markets here and abroad, business can aid in maintaining a high "propensity to consume."

Business alone cannot prevent a depression, and there are times when Government aid is desirable. The Employment Act of 1946 makes the Government responsible for combatting a depression. It states that it is the responsibility of the federal government "to co-ordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment, for those able, willing and seeking to work, and to promote maximum employment, production, and purchasing power."[3] Under the Act, a three-man Council of Economic Advisers was set up, the head of which is now Arthur F. Burns. It is their job to detect trouble and to act to correct it. The Act defines the Government's responsibility to act, but it does not state when it should step in. It is plausible to suggest that the Government is

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1 Ibid.
2 Ibid., p. 18.
3 Employment Act of 1946. Cf. Dimock, op. cit., p. 729.

first justified in interceding in stage two, recession. If industrial production falls off to 15 per cent, the Government should begin to use some of its power. Then, if it continues to drop, more vigorous action should be taken.

What We Already Have

Whatever the Government might do in case of a recession would be supplementary to stabilizing factors already established in the economy. The Social Security program, enacted in 1935, is one cushion under employment. The three main parts of the program are public assistance, unemployment insurance, and old-age and survivors' insurance.[1] The first, public assistance, is financed by general revenues of the Government. Federal grants to the states are used to provide old-age assistance, assistance to the blind, and assistance to dependent children.[2] The purpose of public assistance is to give help to those in financial need but unable to work. Unemployment insurance is financed by taxes (3 per cent) on employers' payrolls in covered occupations--excluding, generally, nonprofit organizations, governmental units, and firms employing less than eight workers.[3] Workers who are willing and able to work but who cannot find employment are aided by this insurance. The purpose of old-age and survivors' insurance is to provide benefits to the workers' dependents and to the workers themselves upon reaching the age of sixty-five. To finance this, the worker is taxed 1½ per cent of his income up to $3,600, and the employer matches that amount. (The rates are scheduled to go up to 2 per cent January 1, 1954.)

Large reserves have been built up during prosperity in the form of trust funds and are available to be paid out in slack periods. Many

1 Dimock, op. cit., p. 724.
2 Vernon A. Mund, Government and Business, Harper and Brothers, New York, 1950, p. 582.
3 Ibid., p. 583.

workers who are employed but old enough to receive old-age benefits would, in case of a decline, retire or be laid off and then fall back on Social Security payments. In 1949, 1.5 million drew on unemployment insurance and 2.75 million drew on old-age and survivors' insurance.[1]

Some see Social Security as the cure-all for depression; others consider it one among many measures necessary to combat a depression. Criticisms of the program are that it extends the field of government operation too far, that accumulation of reserves depresses the economy, that reserves are mixed with general revenues and spent, and that the act does not cover enough people.[2] It must be admitted, however, that the payments do two things; they create purchasing power where there would be none, and the purchasing power created is usually spent immediately, thus stimulating business activity. Marshall Dimock declares that "the net effect on the stabilization of the economy and on depressions, if they occur, is probably as great as any public policy that might be adopted."[3]

A second prop in the economy is the program of farm price supports. The Government supports the parity price at 90 per cent on six basic crops--corn, wheat, cotton, tobacco, peanuts, and rice. Others are declared "non-basic mandatory" and are supported at lower percentages. The parity price is the so-called "fair" price based on the period 1910-1914. Parity is a ratio of the prices received by the farmer to the prices paid by him, using those years as the base. If a farmer does not want to sell his crop at the going market price, he can go to the nearest government office and get a loan amounting to 90 per cent of the parity price of his crop. He puts his crop

1 Dimock, op. cit., p. 727.
2 Ibid., p. 725.
3 Ibid., p. 727.

up as collateral. If the market stays down, he can keep the money, and the Commodity Credit Corporation has title to the product. If the market moves back up, he has the option of paying back the loan and selling the crop at the best price he can get. When the Government supports the price of a crop, it also has the right to regulate the production of that crop. One way is through acreage allotments, applied by the Secretary of Agriculture; and another is through marketing quotas voted by the farmers themselves.[1]

From the above remarks, it is clear that the Government insures a certain income to the farm population. Whether farmers per se should be helped and whether the parity price system is the answer to the farm problem are moot questions. But it must be said that in times of depression it does provide purchasing power in the economy that would not otherwise be there.

Besides supporting farm prices, the Government makes direct loans to farmers for operating and capital expenditures. Federal Land Banks and Production Credit Associations are organized under the Farm Credit Administration. The Land Banks deal in long-term loans requiring first mortgages as collateral whereas the Production Credit Associations extend credit for one year (renewable) to be used for operating expenses. In addition, the Farmers Home Administration makes loans for operating expenses or farm ownership, housing and farm buildings, water facility loans, disaster loans, and assistance to veterans in acquiring farms. The FHA either makes loans itself or insures up to 90 per cent of the borrower's investment in the farm on loans made by private lenders.[2]

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1 "How Farm Laws Tie In With Politics," Business Week, No. 1242 (June 20, 1953), pp. 96, 98, 103.

2 The above account of direct loans to farmers was taken from: United States Government Organization Manual 1953-54, Federal Register Division, National Archives and Records Service, General Services Administration, July 1, 1953, pp. 248-255.

Replacing the Reconstruction Finance Corporation is the Small Business Administration. SBA is empowered "to make loans to enable small-business concerns (ones that are independently owned and operated and which are not dominant in their fields of operation) to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or essential civilian production or as may be necessary to insure a well-balanced national economy."[1] It also makes loans to businesses and people who have been injured by floods or other catastrophes. SBA does not lend to farmers or to veterans. Veterans' loans are given special treatment under other acts.

Even in boom times, some public works are expedient; many projects cannot be postponed until recession periods. For example, some water projects may have to be started to meet increased requirements for power. Moreover, defense areas may necessitate construction of housing and school facilities. Spending on public works falls into two categories, civil and defense. In 1951, $2.4 billion was spent on civil public works; and in 1952, the amount was $3.4 billion. The estimate for 1953 is again $3.4 billion (non-construction costs excluded).[2] Expenditures are made for such projects as veterans' hospitals, public hospitals, housing and community development, schools, agricultural facilities, river basin development and forest preservation, transportation and communication, and federal government buildings and facilities.[3] Out of the $51 billion spent on defense, approximately

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1 Small Business Act of 1953, Section 207. Cf. Loan Policy Statement, Small Business Administration, November 16, 1953, p. 1.
2 The Budget of the United States Government for Fiscal Year Ending June 30, 1953, United States Government Printing Office, Washington, 1952, p. 1183.
3 Ibid., p. 1185.

$3.5 billion (non-construction costs excluded) is spent on defense public works. Such projects include training and testing facilities, warehouses, troop housing, new bases, stockpiling, supersonic wind tunnels, research facilities for aeronautical research, and expansion and conversion of synthetic rubber plants.[1] In addition to these works, state governments are now increasing their expenditures on works such as school buildings and highways. These public works, plus the federal public works and defense spending, compose a huge volume of buying power in the economy. If they remain high, which they undoubtedly will, they will provide a comfortable cushion in case of a general decline.

How Should the Government Act?

Unlike the conditions prior to the Great Depression, today America has many props under economic activity which tend to fortify her against the throes of a bad depression. Over and above these devices already established, other measures might be employed.

Private investment and capital formation is very important because "any attempt to counterbalance a small percentage decrease in private investment necessarily involves a large percentage increase in public investment."[2] Since depreciation reserves are the main way of financing new plants and equipment, allowing business a free hand in depreciating its assets may encourage them to build and expand. Lower interest rates on borrowed money would also be a stimulus. Commercial construction may be encouraged through lower interest rates, cheaper materials, and cheaper labor, if labor is willing to take a decrease in wage rates. Arthur F. Burns believes strongly in

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1 Ibid., p. 1189.
2 Galloway, op. cit., p. 194.

construction as a major means of checking a recession. He believes that "an increase in construction--more than in any other type of activity--causes an immediate upturn in the number of jobs."[1]

Elsewhere in the field of private enterprise, the Government can try to stimulate activity by asking business to pile up inventories in slack periods and then liquidate them during active periods. This would make the inventory factor countercyclical rather than moving with the cycle. Also, the Government can expand its direct loans to farmers, businessmen, and veterans. It can lower the interest rates on the loans, lengthen the period of the loans, and extend eligibility to more classes of businesses. Such a program would be a revival of the idea of the Reconstruction Finance Corporation, the purpose of which was "to aid in financing agriculture, commerce, and industry, to encourage small business, to help in maintaining the economic stability of the country, and to assist in promoting maximum employment and production."[2] It was authorized to purchase the obligations of, and to make loans to, any business organized or operating under the laws of any state or the United States. Furthermore, it could purchase the securities of, or make loans to, states, municipalities, and public agencies provided that the purchases or loans were made to finance specific projects.[3] In the international field, the Government could help business by making guarantees to private business investing abroad--insuring their investments. Under programs of economic and military aid, such as Point 4, American experts, methods, and machines are sent abroad. Expansion of such programs may help maintain the demand for "machine tools."

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1 "He's Watching for Trouble," op. cit., p. 46.
2 United States Government Organization Manual..., op. cit., p. 451.
3 Ibid., pp. 452-453.

Private residental construction now accounts for one third of the total construction in the country (chart No. 8). This illustrates the desirability of keeping the rate of home building high. The Federal Housing Administration, which insures loans to homebuilders, and the Veterans Administration, which insures loans to veterans and in some cases makes direct loans,[1] can encourage home building in two ways. When they insure loans, they can name the interest rate to be charged; therefore, by lowering the interest rates, they can stimulate people to borrow. Moreover, by guaranteeing a higher percentage of the amount of the loans, they can motivate lenders to release their funds.

Without tinkering with the value of the gold dollar, the Federal Reserve has some tools which might be effective in a recession period.[2] The primary objective of the Federal Reserve is "to adjust the flow of money so that it will contribute to economic stability at high levels of production and employment."[3]

Federal Reserve tools for controlling member-bank reserves and the money supply are three in number--the discount rate, reserve requirements, and open market operations. Member banks can borrow from the Reserve Banks, either by discounting notes of their customers or by offering their own notes, secured by readily marketable assets. This borrowing increases member bank reserves. By raising or lowering the discount rate, the Federal Reserve can make it more or less expensive to borrow. Since banks always lend at a higher rate than they have to pay, a change in the discount rate affects, indirectly, the interest rate charged to the banks' customers.

Within limits, the Board of Governors of the Federal Reserve System has the power to set reserve requirements. Raising or lowering them affects the

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1 Ibid., p. 494.
2 The sources for my discussion on monetary policy are:
The Quest for Stability, Federal Reserve Bank of Philadelphia, 1950.
Flexible Monetary Policy: What It Is and How It Works, Committee for Economic Development, New York, March, 1953.
3 The Quest for Stability, op. cit., p. 24.

loans and investments that the member banks can make. An increase in reserve requirements limits the amount of loans and investments a member bank can have outstanding, whereas a decrease would have the opposite effect.

By going into the open market and buying securities (Government securities, mostly), the Federal Reserve increases member bank reserves. The net result is an increase in bank deposits and an increase in bank reserves. Indirectly, the purchases enable banks to expand their loans and investments or to pay off any debts they may have with the Federal Reserve Banks. Open market operations also affect the interest rates. Buying Government securities tends to bid up the price and thus lower the yield. This spreads to private issues. Member banks, too, are likely to lower the interest rates they charge.

Effective recession policy depends on the co-ordination of these three tools. By lowering the discount rate, lowering reserve requirements, and purchasing Government securities in the open market, the Federal Reserve can make it easier for commercial banks to extend credit. However, monetary policy alone is not a panacea. It must be pursued in conjunction with other Government policies.

Monetary measures, along with fiscal policies and expanded public works, may be employed to counteract a recession. In depression, they may be expanded even more.

"Fiscal policy" is defined in two ways, to include all the items of revenue, expenditure, and debt management of the Federal Government, or to include only those policies of spending, taxing, and debt management for counteracting fluctuations in the business cycle.[1] The discussion here is concerned mainly with the latter.

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1 William J. Shultz and C. Lowell Harriss, American Public Finance, Prentice-Hall, Inc., New York, 1949, p. 754.

Deficit spending, though not universally approved, can help in offsetting the cumulative downswings of a recession. It has been defined as "spending by governments in excess of their receipts, with the difference covered by borrowing."[1] According to Marshall Dimock, there are two justifications for deficit spending: when private spending falls off and government spending must take its place to maintain demand, and when government revenues are not sufficient to meet depression expenditures and borrowing must make up the difference.[2] This borrowing may be from individuals or banks. If it comes from individuals, there is merely a transfer of funds; and it does nothing to stimulate activity unless the funds turned loose had been hoarded. On the other hand, borrowing from banks is, in itself, inflationary. When the Government sells bonds to the Federal Reserve, new money is created. This type of borrowing, then offsets the contracting tendency of money in a recession.

One way of forcing deficit financing is through tax reduction. Especially in the last few years have taxes become extremely important in the economy. Every tax absorbs purchasing power. However, since this purchasing power is usually poured back into the national income stream, it is simply detoured through Government hands. Whether national income is increased or decreased because of taxes depends on the "reproductiveness" of the Governmental expenditures.[3] If the Governmental expenditures are more reproductive than private expenditures would have been, then national income will be increased. The effect of taxes on consumption depends on the income brackets of the consumers and their psychology. Taxes borne by the low income groups tend to

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1 Ibid., p. 755.
2 Dimock, op. cit., pp. 723-724.
3 Shultz and Harriss, op. cit., p. 231.

reduce their consumption. The same is true of those with moderate incomes. For those with larger incomes, saving is the elastic feature rather the consumption.[1] Taxes also have an impact on saving. Saving is retarded by taxes when they "rest chiefly upon income which otherwise would be primarily saved, reduce the return upon invested capital, penalize the procedure of saving, and absorb saved income before it is invested in new enterprise."[2] Likewise, any tax that has an adverse effect on saving in the long run also lessens investment in new capital goods.[3] Excise taxes, personal income taxes, and corporation income taxes are the ones that have the greatest effect on consumption, saving, and investment. Therefore, it should be the rates of these that should be reduced. By reducing tax rates and maintaining Government expenditures through deficit spending, additional money will be pumped into the income stream. Consumption will be stimulated if the reductions ease the burden of the low income groups. If the taxes reduced are those levied on high income groups, the additional money will probably be saved.[4] Hoarding will depress activity; but, if the savings are invested, business will be stimulated.

Another way of forcing deficit financing is through spending on projects not previously undertaken. "Pump priming" is the name usually given this sort of spending. This type of spending may have several forms, such as relief allowances and public works. Even though relief payments do put money into circulation, they should not be used unless absolutely necessary, for they tend to lower morale and discourage initiative. In the field of public

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1 Ibid., p. 232.
2 Ibid., p. 234.
3 Ibid., p. 237.
4 Ibid., p. 241.

works, there are many projects that would be of value; unlike relief payments, public works offer lasting improvements to the country as a whole. Crowded schools need to be enlarged, super highways need to be constructed, power plants need to be built. Right now, there are $15 billion worth of plans already approved by Congress that could be used.[1] In one month, Burns could bolster highway spending by $100 million.[2] By increasing federal grants-in-aid to the states and local governments, by implementing new regional development programs and other civil public works programs, and by increasing stockpiling and atomic energy expenditures, the Government can create jobs and pump purchasing power into the economy. This purchasing power serves as a stimulus to market demand and employment.

One must not be led to believe that a program of public works presents no difficulties. Heavy construction projects must be combined with light construction projects.[3] Planning and scheduling must be done in advance, and the projects must be properly timed.[4] This is very hard to do. Moreover, the projects should not compete with private enterprise so as not to discourage private initiative. To be successful, the program must coincide with other Government functions such as tax reductions.

Controversy is widespread over "pump priming" programs. Keynes used his contention that economic systems do not necessarily tend toward full employment as a basis for advocating constant "pump priming" to achieve the desirable objective of full employment. Others claim that the economic system tends toward chronic stagnation and thus constant government spending is essential. Some say that temporary recovery spending in depression is sufficient. Still

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1 George B. Bookman, "Small Decline on Horizon," Life, vol. 36 (January 4, 1954), p. 22.
2 "Public Works, The U. S. Plans for Its Future," Time, vol. 62 (September 7, 1953), p. 88.
3 Dimock, op. cit., p. 721.
4 Ibid.

another group advocates a countercyclical policy. Through high taxes in periods of prosperity, surplus financing can be achieved so as to allow for paying off the debt incurred in periods of depression. In general, it can be concluded that "so long as recession and depressions occur, part of the price one must expect to pay for the unreliability of the free enterprise system is deficit spending."[1]

Conclusion*

Can the Government prevent an economic depression? Even the experts find this a most difficult question to answer. Burns, himself, is quite noncommittal, pledging allegiance to no particular theory and attempting to predict nothing about the future. Apparently, an unqualified answer is not forthcoming.

My answer is that the Government can prevent a depression under certain conditions and cannot under others. The necessity of high rates of consumption and investment toward maintaining full employment is manifest from past experience. Government spending and stimuli to investment through the foregoing measures can do much to maintain a high level of economic activity. These Government programs, however, must be well conceived, well co-ordinated, and well timed so that one will not counteract the other. Businessmen and consumers must also do their part. Of the three types of spending--business, consumer, and government--consumer spending is the largest. Therefore, no one factor alone is sufficient to repel a serious decline. Yet, if the Government will put forth its efforts vigorously in a recession and use its methods to bolster and encourage business activity, and if businessmen and consumers will co-operate, a depression can be prevented. On the other hand, if efforts fail in stage two, recession, and if industrial production

1 Ibid., p. 724.

* In this paper, I have not attempted to discuss the view of the present Administration because the official view, the Economic Report of the President, has not yet been sent to Congress. Neither can such a paper as this incorporate the latest news in today's newspaper. To even attempt this would necessitate many revisions.

falls more than 33 per cent, it is doubtful that the Government could prevent a bad depression. Its deficit spending and public works may mitigate it but not cure it; it would run its course.

It can be concluded that the "quest for stability" is everyone's job. We can have full employment of men and resources if we have the will. Only the future can write the absolute answer.

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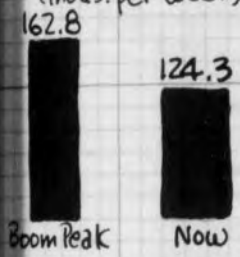
No. 1

WHAT'S GOING ON IN BUSINESS

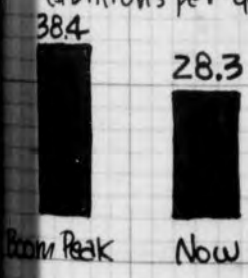
New Construction
($ billions per yr.)

Auto Output
(thous. per week)

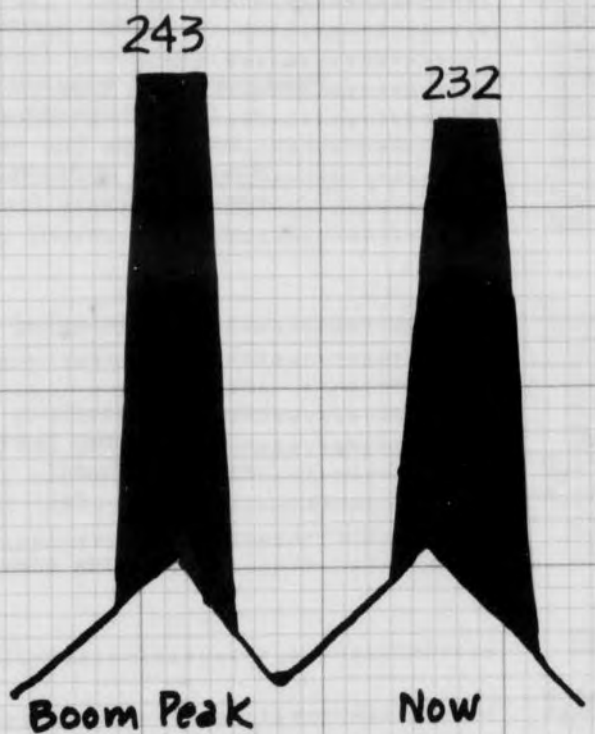


Weekly Earnings
(dollars)

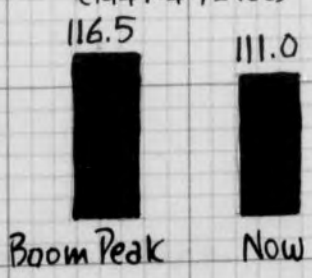
Farm Cash Income
($ billions per year)



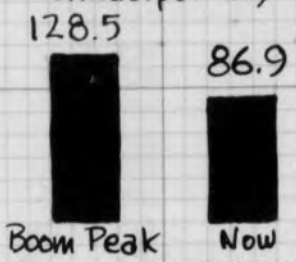
Industrial Production
(1925-39 = 100)



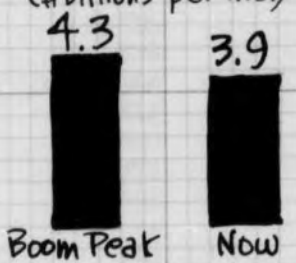
Wholesale Prices
(1947-49 = 100)



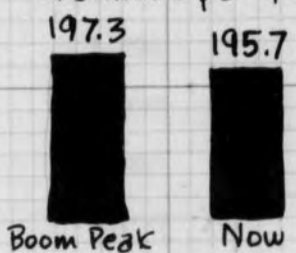
Housing Starts
(thous. per mo.)



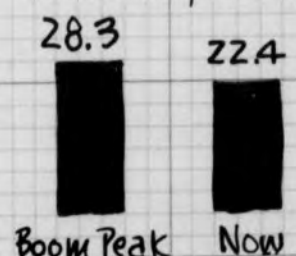
Arms Spending
($ billions per mo.)



Wages & Salaries
($ billions per yr.)



Factory Orders
($ billions per mo.)



Source: U.S. News and World Report, November 13, 1953, p. 31

CAPITAL SPENDING CONTINUES TO CLIMB

(figures in millions)

	1952	1953(Est.)
MANUFACTURING	$11,994	$12,039
Durable goods industries	5,784	5,523
Primary iron and steel	1,538	1,350
Primary nonferous metals	595	529
Fabricated metal products	355	328
Electrical machinery and equipment	376	444
Machinery except electrical	772	822
Motor vehicles and equipment	896	872
Other transportation equipment	253	211
Stone, clay and glass products	318	270
Other durable goods	682	697
Nondurable goods industries	6,210	6,516
Food	540	506
Beverages	245	285
Textile mill products	400	314
Paper and allied products	354	380
Chemicals and allied products	1,451	1,571
Petroleum and coal	2,596	2,858
Rubber	139	134
Other nondurable goods	484	469
MINING	880	910
RAILROAD	1,391	1,294
OTHER TRANSPORTATION	1,363	1,380
PUBLIC UTILITIES	3,838	4,368
COMMERCIAL AND MISCELLANEOUS	6,989	7,000
TOTAL	$26,455	$26,991

Source: BUSINESS WEEK, March 28, 1953, p. 34

BUSINESS IS WAY UP---CAN IT STAY THERE?

		PRE-KOREA	NOW
TOTAL ACTIVITY(gross national product)....	UP 32.1%	$280 billion	$370 billion
BUILDING VOLUME.....	UP 24.9%	$28.1 billion	$35.1 billion
GOVERNMENT SPENDING.....	UP 109.7%	$40.3 billion	$84.5 billion
OUTPUT OF GOODS(1935-39= 100).....	UP 23.6%	195	241
SPENDING ON PLANT EQUIPMENT.....	UP 47.9%	$19.2 billion	$28.4 billion
RETAIL TRADE.....	UP 19.3%	$145 billion	$173 billion
STEEL OUTPUT.....	UP 16.5%	99.6 million tons	116.1 million tons
EMPLOYMENT.....	UP 6.7%	60.9 million	65 million
RETAIL PRICES(1947-49= 100).....	UP 11.7%	99.4	111
INVENTORIES OF GOODS.....	UP 43.1%	$53.8 billion	$77 billion
PERSONAL INCOMES.....	UP 28.6%	$220 billion	$283 billion
MONEY SUPPLY.....	UP 12.7%	$110 billion	$124 billion

Source: U.S. News and World Report, August 7, 1953, p. 12

No. 5

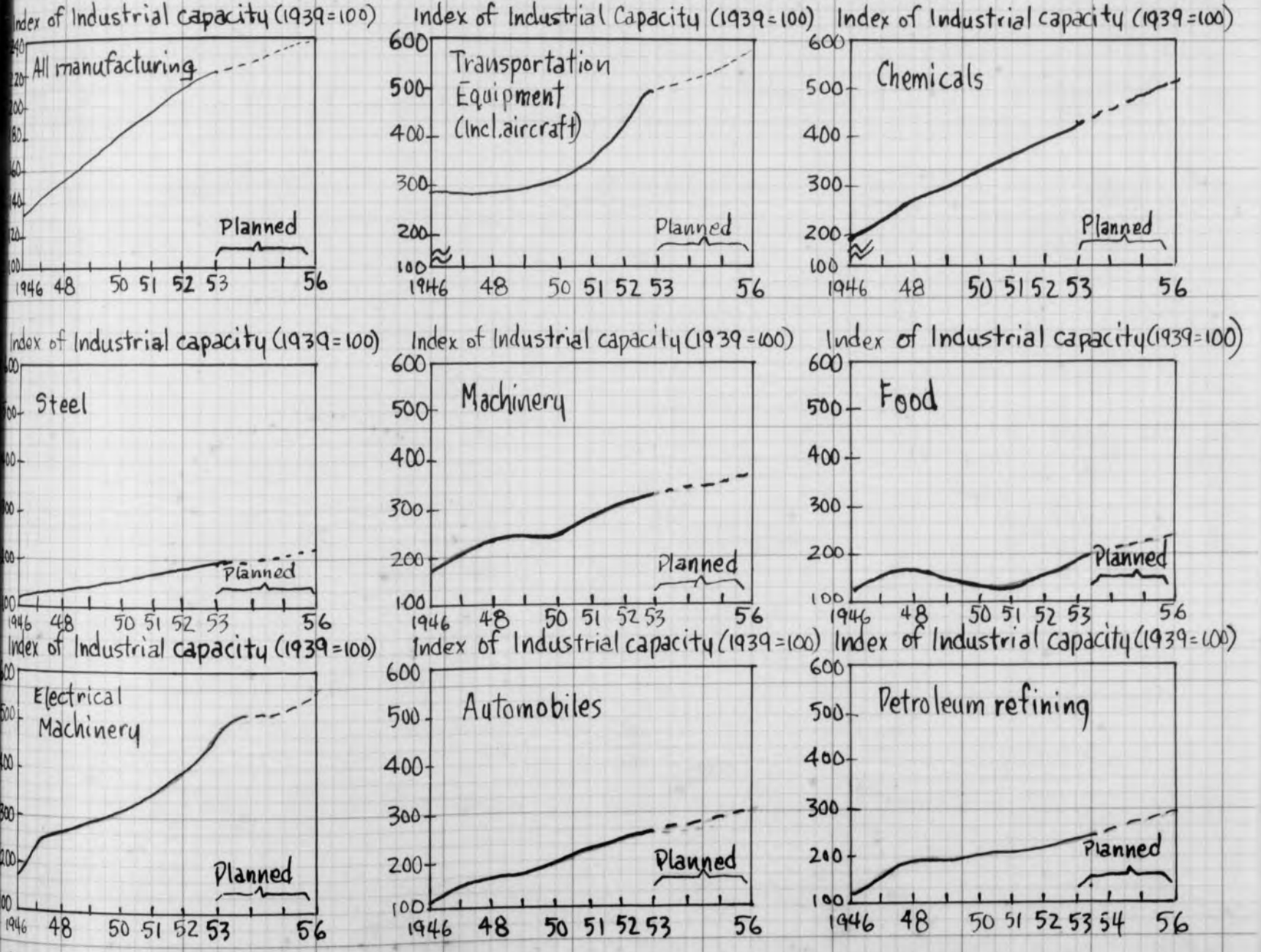
HOW BUSINESS PLANS CAPITAL EXPENDITURES

(millions of dollars)

No. 4

INDUSTRY'S PLANS FOR CAPITAL SPENDING: STILL ON A BIG SCALE

How Manufacturing Industries are Increasing Capacity



Source: Business Week, April 4, 1953, pp. 112-113.

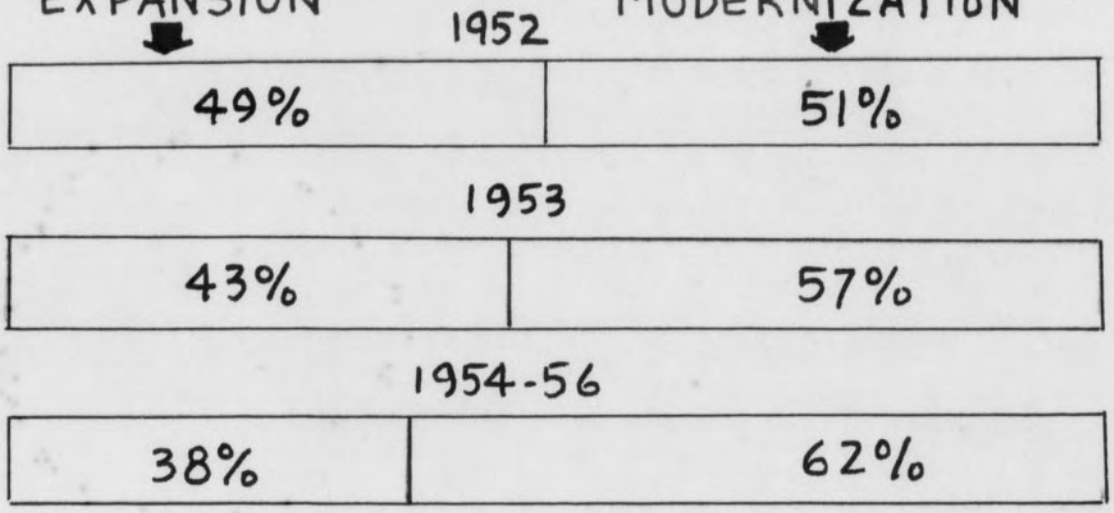
HOW BUSINESS PLANS CAPITAL EXPENDITURES

(millions of dollars)

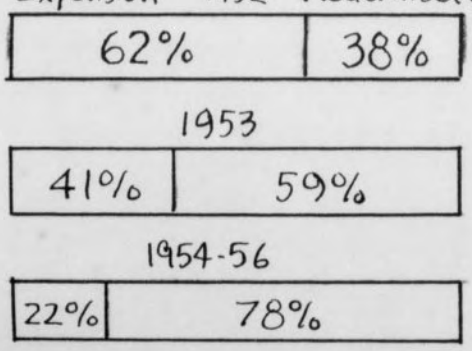
	Actual	Planned	Preliminary Plans		
	1952	1953	1954	1955	1956
Steel	1538	1246	748	623	785
Machinery	772	749	577	532	502
Electrical Machinery	376	549	483	395	302
Automobiles	896	1066	949	768	693
Transport Equipment (including aircraft)	253	309	182	56	37
Food	785	879	686	677	677
Chemicals	1451	1364	1309	1228	1350
Petroleum and coal products	2596	2908	2792	2588	2530
Textiles	400	396	368	305	281
Other Manufacturing	2927	2634	2028	1817	1817
All Manufacturing	11994	12100	10122	8989	8974
Mining	880	1003	832	682	692
Railroads	1391	1210	823	835	871
Electric and gas utilities	4750	5883	5572	5467	5467
Other transportation and communication	2961	3139	3305	2741	2456
ALL INDUSTRY	21976	23335	20654	18714	18460

Source: Business Week, April 4, 1953, p. 117.

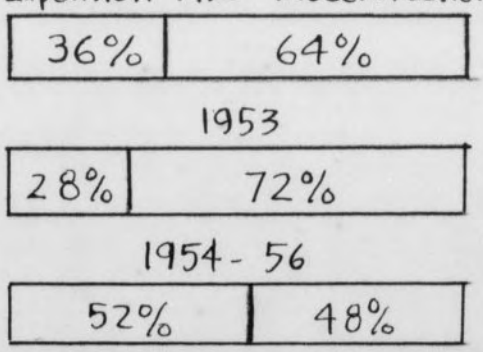
How Manufacturers Divide Their Spending Between



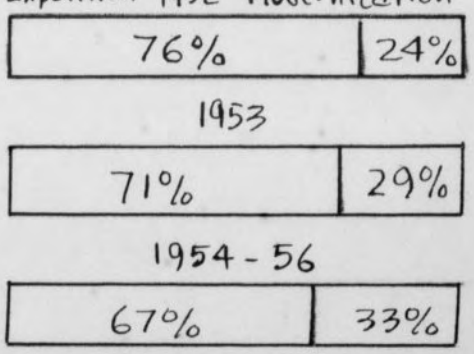
STEEL



AUTOMOBILES



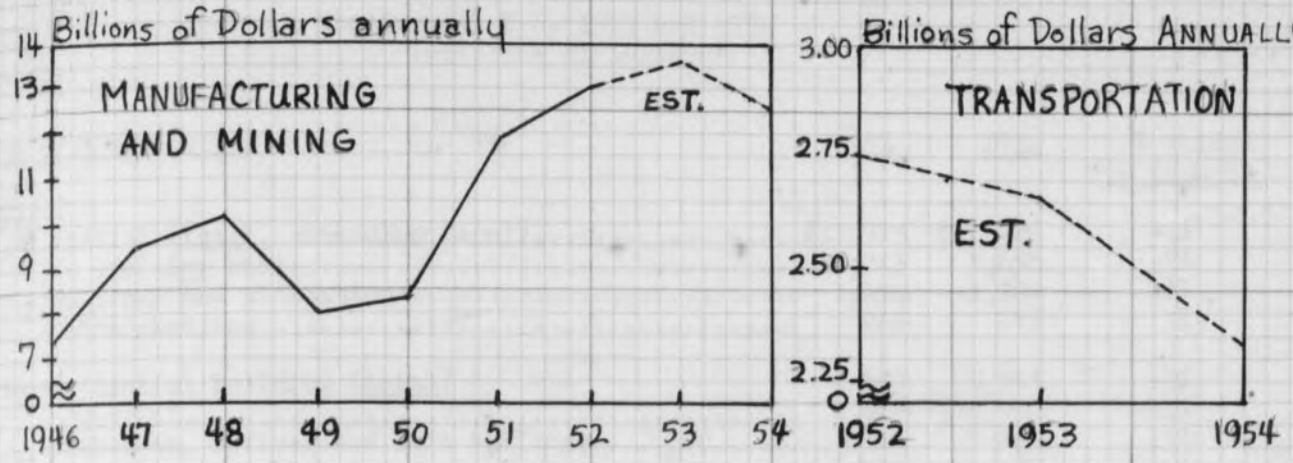
CHEMICALS

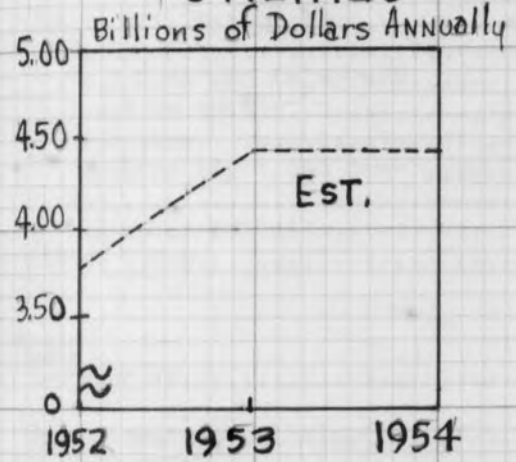


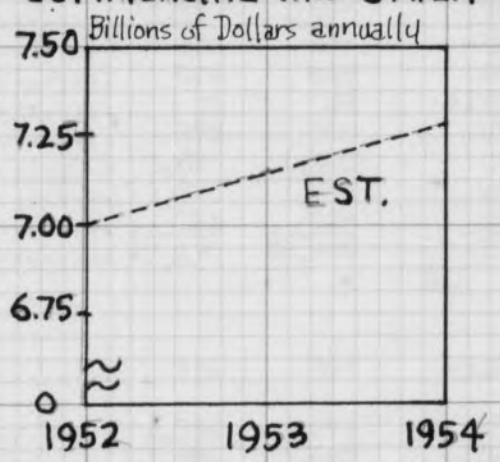
Source: Business Week, April 4, 1953, p. 114

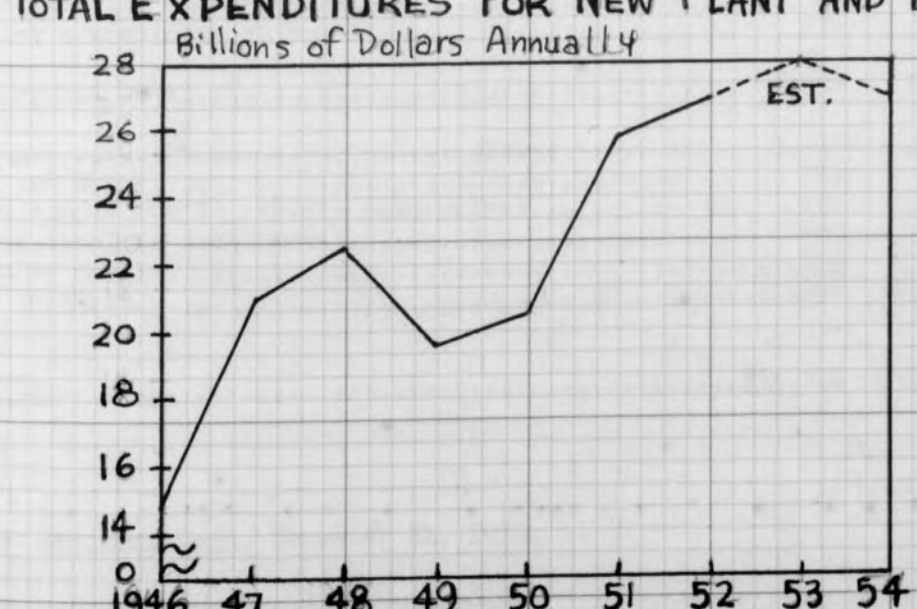
CAPITAL GOODS EXPENDITURES

No. 7









Source: Business Week, November 7, 1953, p. 27

OUTLOOK FOR NEW CONSTRUCTION

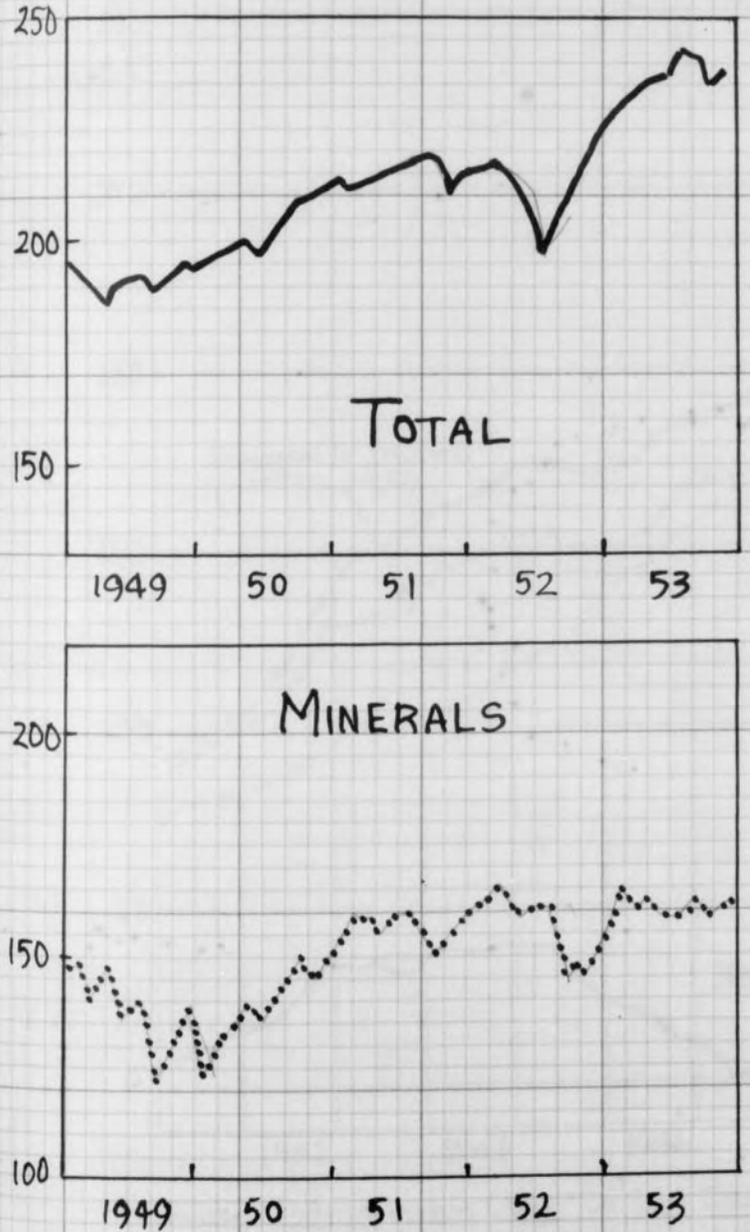
Continental U.S. 1953 and 1954
(millions of dollars)

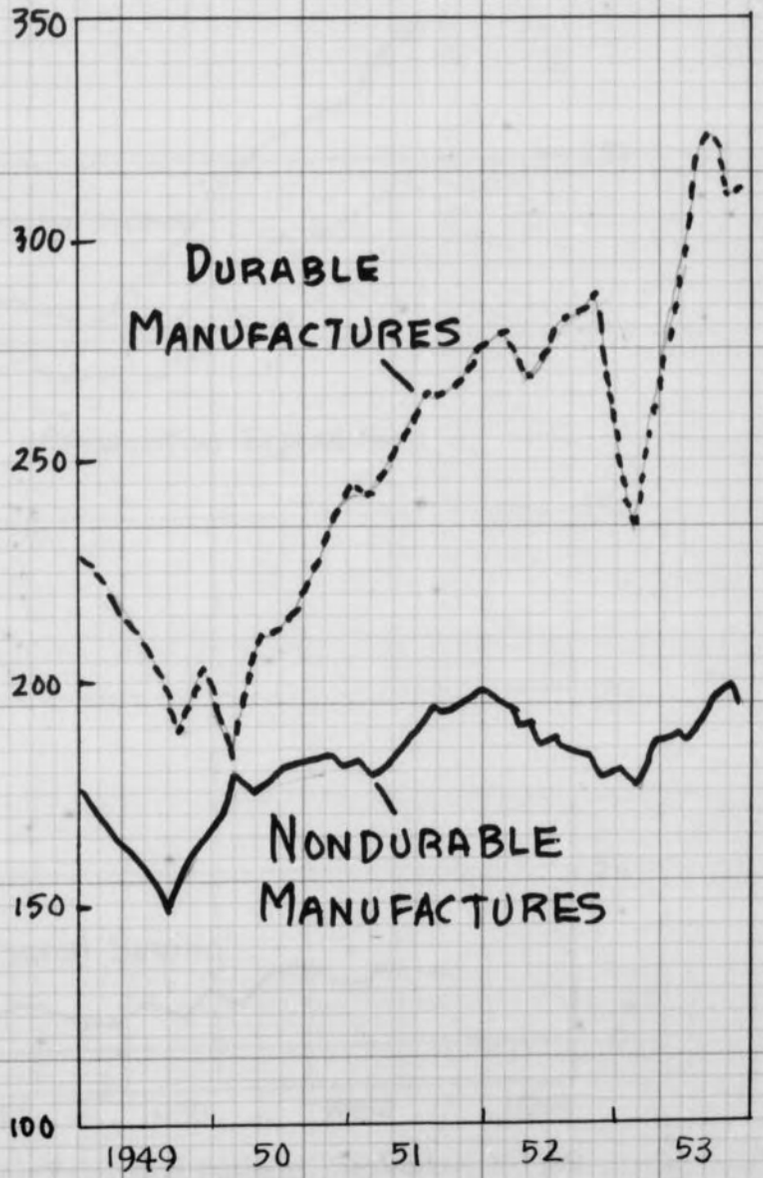
TYPE OF CONSTRUCTION	1953	1954	% change 54 from 53
PRIVATE			
Residential (total, excluding farm)	$11,715	$11,225	-4%
New dwelling units	10,345	9,650	-7%
Additions and alterations	1,104	1,300	18%
Nonhousekeeping	266	275	3%
Nonresidential Building (total)	5,689	5,575	-2%
Industrial	2,263	1,950	-14%
Warehouses, offices and loft buildings	740	850	15%
Stores, restaurants, and gara ges	1,035	1,100	6%
Other nonresidential building	1,651	1,675	1%
Farm Construction	1,475	1,300	-12%
Public Utility (total)	4,430	4,575	3%
Railroad	480	475	-1%
Telephone and telegraph	600	625	4%
Local transit	30	25	-17%
Pipe line	270	300	11%
Electric light and power	1,825	1,900	4%
Gas	1,225	1,250	2%
All other private	121	125	3%
PRIVATE TOTAL	23,430	22,800	-3%
PUBLIC			
Residential	551	365	-34%
Nonresidential Building (total)	4,339	4,275	-1%
Industrial	1,786	1,600	-10%
Educational	1,742	1,925	11%
Hospital and institutional	341	275	-19%
Other nonresidential building	470	475	1%
Military and Naval	1,360	1,200	-12%
Highways	3,145	3,450	10%
Sewer and water	761	825	8%
Miscellaneous public service enterprises	196	200	2%
Conservation and development	833	750	-10%
All other public	105	135	29%
PUBLIC TOTAL	11,290	11,200	-1%
GRAND TOTAL	$34,720	$34,000	-2%

Source: Business Week, November 21, 1953, p. 31.

INDUSTRIAL PRODUCTION

Per Cent Physical Volume, Seasonally Adjusted, 1935-39 = 100



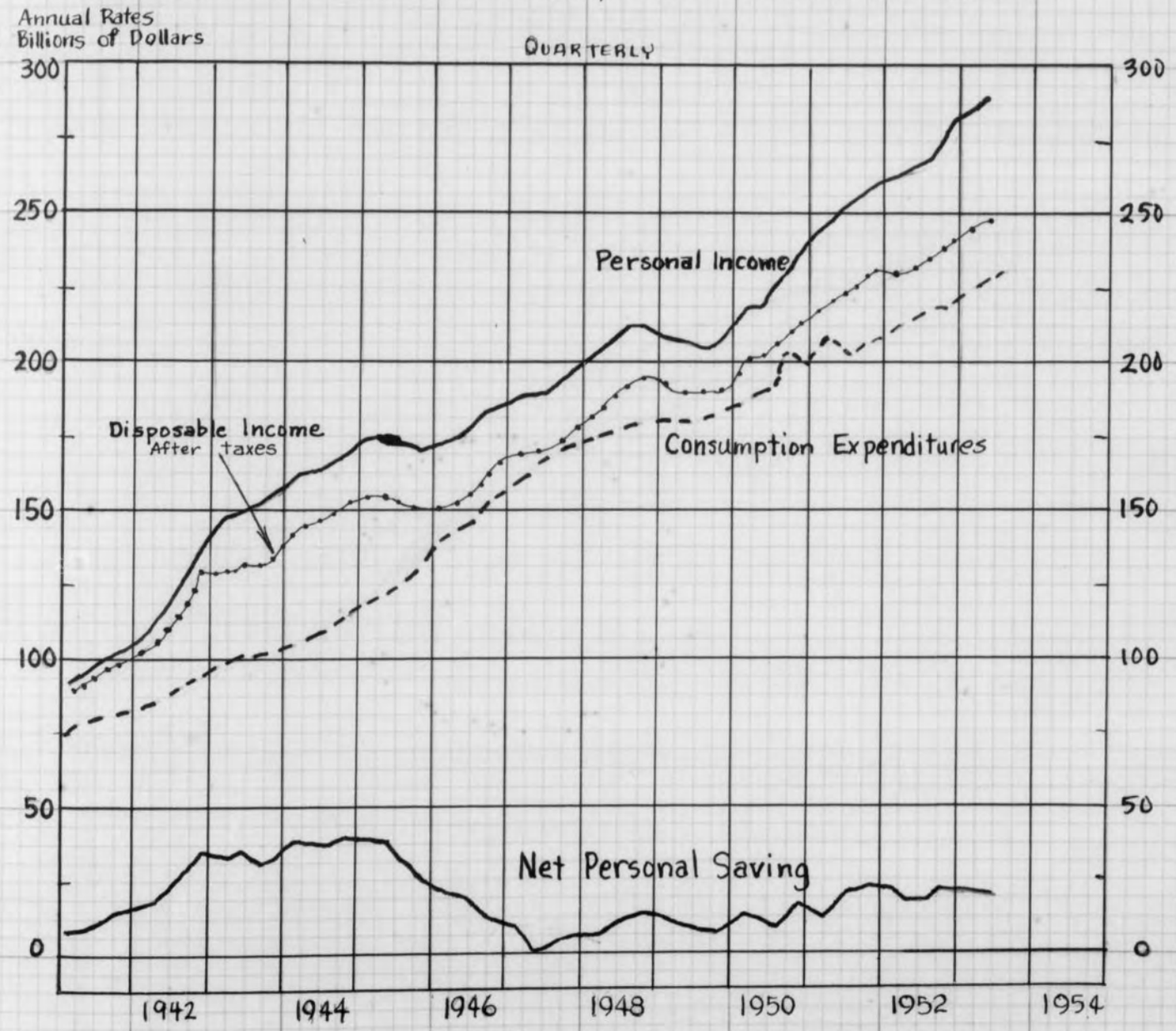


Source: Federal Reserve Bulletin, September, 1953, p. 953

No. 10

PERSONAL INCOME, CONSUMPTION, AND SAVING

Department of Commerce Estimates, Adjusted for Seasonal Variations

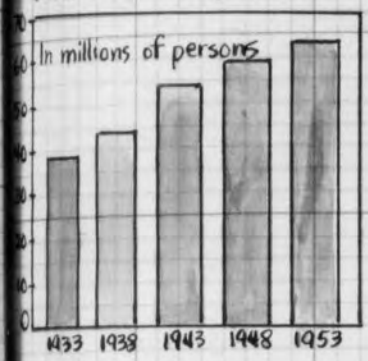


Source: Federal Reserve Charts on Bank Credit, Money Rates, and Business. September, 1953 p. 51

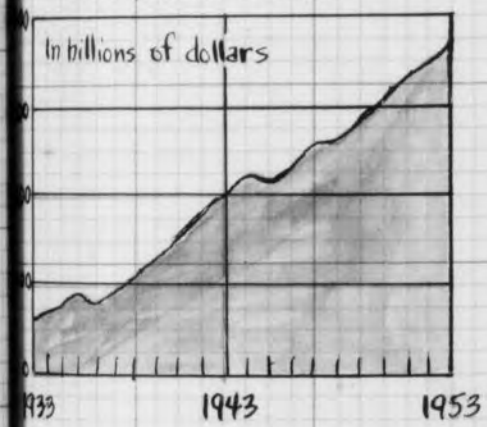
Conflicting Signs In The Economic Picture No. 11

Favorable Signs

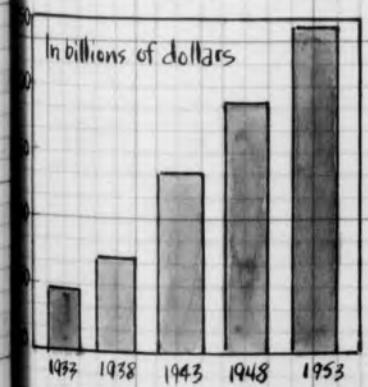
More people are working
(total Civilian employment)



Production is rising
(Gross National Product)

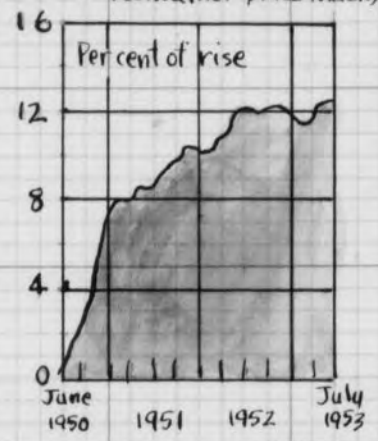


Workers have more to spend
(disposable personal income)

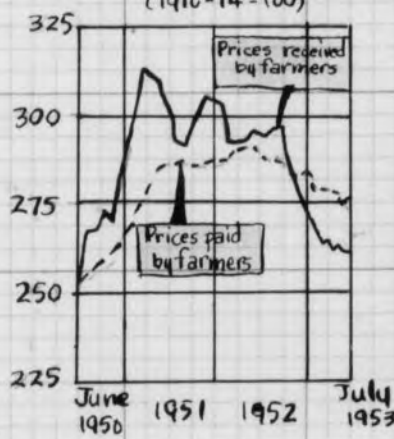


Unfavorable Signs

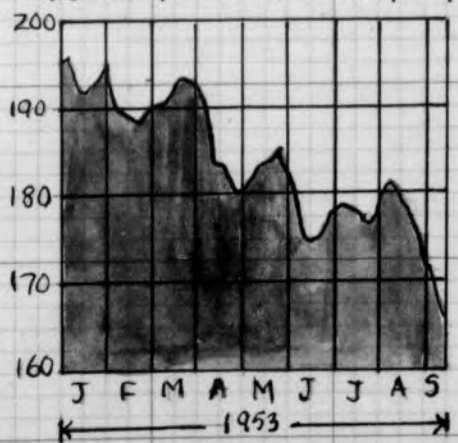
Prices Continue to rise
(consumer price index)



Farm Income Is Down
(1910-14=100)



Stock Market Is Off
(The New York Times Weekly Avgs.)



Source: The New York Times,
Sept. 13, 1953, P. B9.