Monetary and Fiscal Counter-Depression Policy: An Analysis Correcting Keynes' Ignoring of Tax Burdens

Author(s): Harry Gunnison Brown

Source: *The American Journal of Economics and Sociology*, Jul., 1959, Vol. 18, No. 4 (Jul., 1959), pp. 337-351

Published by: American Journal of Economics and Sociology, Inc.

Stable URL: https://www.jstor.org/stable/3484822

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at https://about.jstor.org/terms

is collaborating with JSTOR to digitize, preserve and extend access to *The American Journal of Economics and Sociology*

This content downloaded from 149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

The AMERICAN JOURNAL *of* ECONOMICS *and* SOCIOLOGY

Published QUARTERLY under grant from the Robert Schalkenbach Foundation in the interest of constructive synthesis in the social sciences.

VOLUME 18 | JULY, 1959 | NUMBER 4

Monetary and Fiscal Counter-Depression Policy:

An Analysis Correcting Keynes' Ignoring of Tax Burdens

By HARRY GUNNISON BROWN

IN THE LAST TWO DECADES "liquidity preference" has been very much a term to conjure with. But just what does it mean and what is its significance for the understanding of economic phenomena?

The late Lord Keynes, widely regarded as the principal authority on the subject, related it closely to hoarding. "The concept of *Hoarding*," he said,[1] "may be regarded as a first approximation to the concept of *Liquidity-preference*. Indeed, if we were to substitute 'propensity to hoard' for 'hoarding,' it would come to substantially the same thing." If this is so, "liquidity preference" is really just a part of the theory of the velocity of circulation of money and checking accounts. The greater "liquidity preference" is—*i.e.,* the greater the "propensity to hoard"—the lower will be, other things equal, the velocity of circulation. But since other things are often very unequal, the theory of liquidity preference can be only a part of the theory of velocity. Perhaps, indeed, liquidity preference is a small and relatively unimportant part of this theory!

"Liquidity preference" has been presented with particular emphasis on desire for liquidity in preference to a relatively low per cent gain on investment. But there may likewise be a degree of preference for liquidity as compared with the enjoyment of consumers' goods or services. One may give up some pleasure today, not necessarily because he prefers any

[1] *The General Theory of Employment, Interest and Money,* New York, Harcourt, Brace and Co., 1936, p. 174.

This content downloaded from 149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

specific different pleasure today or tomorrow or next week, but because of the possibility that some special opportunity will come to him—or some emergency arise—for which he will be ready if he has not spent his money for today's pleasure. "Household gadgets that are now, apparently, all right, may break or unexpectedly wear out and need to be replaced. Clothes may become badly torn. There may be unexpected occasion to go to a distant city by airplane, bus or train. Exceptionally good shows may come to town before the next salary check is received. And even apart from such considerations as these, the average person likes to have time to decide at his leisure among the various goods for which he may spend his money."[2] In such cases his preference is not for any specific good or pleasure, but for the "liquidity" which may—yet may not—be advantageous to him at some indeterminate time and in some unforeseen way. If one wants merely not to be hurried into particular expenditures without adequate time to "shop around" and thus be sure that he is buying what he most needs or wants, certainly he is manifesting liquidity preference. And whenever he buys something, he is to that extent sacrificing liquidity.

I

WE LIVE IN A SOCIETY where there is a high degree of specialization and where we must, each of us, exchange the goods we produce for goods produced by others, where buyers have many choices, and where we both have and need to have a medium of exchange to facilitate these exchanges. *Some* degree of liquidity, therefore, is almost a *must* for each of us, that we be not forced to accept and pay for whatever goods come first to our attention, with no chance for deliberation. Our economic system would indeed operate poorly if most of us could have no liquidity at all. Must we nevertheless conclude, perhaps, that in the desire for liquidity there lurks something ominous and something that threatens the system of free markets and free private enterprise?

Suppose, now, we consider the results that follow from rapid increase of circulating medium and the associated price-level inflation. What about liquidity preference then? Do not such conditions put so much pressure on people to spend—*or invest*—quickly, and especially if the price level increase is rapid, that they may not feel they can possibly afford to "shop around?" Their purchases of consumers' goods must be hurried—perhaps to the point of great waste and loss—lest if they delay, their money will buy so very little. Their purchases of business capital

[2] Quoted from my *Basic Principles of Economics*, third edition, Columbia, Mo., Lucas Brothers, 1955, Vol. II, p. 39.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

must be hurried—perhaps to the point of foolish, because too little considered, investment—since with delay their money is worth so very much less. Rapid inflation makes the maintaining of liquidity so costly, that those who have any understanding feel they cannot possibly afford it. They feel that they *must* part with liquidity as quickly as possible, lest in trying to keep their assets liquid, they will soon have no assets at all—or almost none.[3]

Although Keynes asserted that "propensity to hoard" is "substantially the same thing" as "liquidity preference," it may be permissible to inquire whether "liquidity preference" is not a misleading term when applied to some hoarding, or to the tendency to hoard under some conditions. Consider the situation when prices are falling several per cent per year and when there is a fairly widespread belief that they will continue to fall for some time. If, in such circumstances, many persons delay purchases—including purchases of income-yielding property—in the thought that their money will buy more for them next month or next year than now, are they motivated by a preference for liquidity as such, or are they motivated by a preference for more as against less? How does the case differ essentially from that of a man who owns a piece of land which he believes will rise greatly in value, and who holds on to it, refusing to dispose of it *now,* because he expects to get *more* by waiting? When prices-in-general are steadily *falling,* is not the man who is holding *money* (or a checking account) thinking much less, if at all, about the advantage to him of liquidity, than he is about the advantage of value *appreciation?*

Consider now the related case of the manufacturer who *fears* that if he invests in raw materials and machinery and hires labor in order to produce manufactured goods, he cannot sell them for *as much* as he paid to produce them. Or consider the case of the merchant who *fears* that if he lays in a stock of goods to sell, he will not be able to sell them for the equivalent of his outlays for goods, salespeople, etc. In these cases, is the desire to maintain liquidity the dominating influence, or is the chief influence a definite *fear* of suffering positive *loss?* And a sufficiently sharp and persistent restriction of bank credit can certainly generate such fear.

Or again, consider the case of a worker who, as unemployment increases, begins more and more to fear that he, too, will lose his job. If, therefore, he and his family do their best to avoid unnecessary expense and to keep their money—or checking account—as large as possible in fear of such

[3] Of course a person can have some degree of liquidity by purchasing platinum, silver, jewelry or other durable goods of somewhat stable value. But these things are not as readily exchangeable and, therefore, do not provide as great liquidity as does money when the money is reasonably stable in its purchasing power.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

unemployment, is it primarily the maintenance of liquidity, as such, that they have in mind? Might they not be willing to lay aside, instead, milk, cheese, meat and other consumable goods, *except* that these are perishable? Is not their motive chiefly one of spreading their limited means over a longer *time,* rather than one of keeping "liquid?"

But in all of these cases, whether or not they involve "liquidity preference," there will be a reduction in the velocity of circulation of money.

II

AT THIS POINT we may pause to ask whether liquidity preference ever did actually start a significant depression or whether it was ever the chief predisposing cause of such a depression. Perhaps, instead, liquidity preference *and* the decreased velocity of circulation resulting from it or from the other causes suggested above, are always sequential to and a result of bank credit restriction or other action or circumstance tending to reduce the circulating medium. In any case, it does not seem unreasonable to ask whether there is real evidence that liquidity preference has ever been the—or even a—significant *initiatory* force in bringing on a depression.

Keynes refers to the experience of Great Britain and the United States after the first world war as "actual examples" showing that accumulation of wealth can be great enough to reduce the marginal yield of capital—what a last increment or unit of capital can add to production—more rapidly than the rate of interest can fall[4] in view of "prevailing institutional and psychological factors." Here we must note that Keynes *defines* the rate of interest as "the reward for parting with liquidity for a limited period." The post-war events in these countries, he concludes, showed that "in conditions mainly of *laissez faire,*" such a fall in the marginal yield of capital can interefere "with a reasonable level of employment" and with the standard of life that "the technical conditions of production" could otherwise provide.

But surely, so far as the United States was concerned, the sharply restrictive policy of the Federal Reserve system in 1920–21, and again in 1929 and after, must have been of dominating influence on the events and conditions that followed.[5] How was it possible for Keynes to attribute these depressions so confidently to liquidity preference, in view of the known antecedent facts? Dr. Clark Warburton's carefully worked out

[4] *Op. cit.,* p. 219 and, for "definition of the rate of interest," p. 167.

[5] *Basic Principles of Economics, op. cit.,* Vol. II, pp. 160–3 (in chapter entitled "Two Decades of Decadence in Economic Theorizing").

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

statistical data[6] provide impressive evidence that it was bank policy—and not an initiatory spurt of liquidity preference—that can most reasonably be regarded as the principal effective and sufficient cause.

Cogent theory, too, points to the conclusion that a great and rapid decrease of circulating medium must inevitably—or almost inevitably—bring about dull business and unemployment. If the volume of circulating medium declines, during a relatively short period, by (say) a third, how *can* as many goods be purchased or as many workers be hired?

There is, of course, no *mathematical* reason why depression and unemployment must ensue just because the total volume of spending is reduced by a third. These results would not manifest themselves *if* prices, wages, rentals etc., would all decline in as great proportion—*and as quickly*—as the volume of spending. For even though only two-thirds as much money is spent for commodities, just as many commodities can be and will be purchased with this decreased money provided the commodities sell for only two-thirds the previous prices. And even though only two-thirds as much money is spent in the hiring of labor, as many workers can be and will be hired and for as many hours, provided wages are only two-thirds as high. And likewise with the leasing of houses and of business property and other business transactions.

But who will assert that such a decrease of money and resulting decrease of demand for goods and for labor would be immediately succeeded by acceptance of equally reduced prices, wages and rentals? Who will assert that the necessary proportionate reduction in prices (including retail prices as well as wholesale and raw material prices) and of wages and rentals would come within a month or two? Would trade union leaders quickly agree to a one-third reduction in wages? Would real estate owners who have leased their property to business concerns for a ten-year period or longer at agreed rentals, quickly agree to a one-third cut in these rentals? Who, indeed, will declare with confidence that such a reduction of prices and of rentals and wages would come within several months—or even a year?

But then it may be argued by some that even with a great reduction in the number of dollars *available* to spend, there need be no proportionate reduction in the number of dollars spent—or no reduction at all! Men will make up for the decrease, it may be said, by spending money that

[6] See "Hansen and Fellner on Full Employment Policies" in *American Economic Review*, 38 (March, 1948); "Monetary Velocity and Monetary Policy" in *Review of Economics and Statistics*, 30 (November, 1948), especially p. 309; "Bank Reserves and Business Fluctuations" in the *Journal of the American Statistical Association* 3 (December, 1948).

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

they had been holding for emergencies. That is, the *velocity of circulation* of money will be greater!

Yet to suppose that there is *no reduction at all* in the amount of money and bank checking accounts spent is to suppose that a man *will spend as many dollars when he has few as when he has many!* The truth is, whatever may be the mathematical possibilities in the case, that human beings spend less money when they have less money, and that to reduce the amount of money and checking accounts in a country causes less to be spent than if the amount of money had not been reduced. Hence the demand for goods declines and prices tend downward.

Indeed, there is a reasonable probability that a decrease in the number of dollars, before very long and at least for some time, will reduce the number of dollars spent in even greater proportion. For the decrease of demand for goods and the incipient fall of prices may give rise to anticipation of further fall of prices. Thereby it may induce business men to delay spending their money lest the goods they purchase with it prove unsalable except at a loss; or may induce consumers to delay spending in the hope of finding better bargains later. That is to say *velocity of circulation* of money may not only fail to become greater but may actually become less.

Under such circumstances, business can remain as active as before only if prices fall even more rapidly than the decline in the number of dollars.

If, however, commodity prices do fall in a sufficient ratio, this will still not insure business activity if at the same time such business expenses as rentals and wages remain comparatively rigid. Thus, if commodity prices fall because of a decrease of money and bank credit, and yet wages do not fall in anything like the same proportion, then the goods produced by labor will not sell for enough to pay these rigidly held wages. Demand for labor must and will decline, unemployment must result and production be cut down.

If charges made by owners for the use of land and capital are rigid despite falling commodity prices, there will be more land and capital left unused. In consequence, labor will be less well equipped with the means of production, will produce less, and must accept even lower wages than otherwise if it is to be employed.

The truth probably is that central banking policy has more to do than anything else with the alternation of prosperity and depression, and that central banking policy affects business activity through affecting the volume of circulating medium of which bank deposits subject to check are, at any rate in the English-speaking countries, the major part. Unduly sharp and

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

persistent bank credit restriction can quickly turn prosperity into depression. This of course does not mean that those who control central banking policy deliberately seek—or have ever sought—to bring about depression. It means rather that bank credit policy may be, and sometimes is, inept, so that evil consequences ensue which the determiners of policy did not intend or expect.

But all this is not to say that, in theory, liquidity preference, or a change in liquidity preference, could have no possible effect on the velocity of circulation of money and checking accounts and, therefore, on other economic phenomena.

III

IN ORDER TO EXPLORE the liquidity preference problem theoretically, let us assume, first, the case of a country having a gold standard. Citizens are saving and investing. Capital is increasing in relation to labor and to land. The marginal net gain (above repairs, depreciation and taxes on the capital and/or its income) from additional units of capital grows less. The net per cent marginal productivity (or "efficiency," if the Keynesian term is preferred) of capital declines. Conceivably it declines to so low a point that an increasing proportion of citizens would prefer *either* to enjoy more in the form of consumers' goods *or* to hold ("hoard") money or checking accounts out of circulation for such uses in the future as may then appeal to them.[7] The tendency or "propensity" to hoard, under such circumstances would be (according to the statement of Keynes with which this paper began) "liquidity preference." What would be the probable consequences?

Such a situation would mean, in one of its aspects, *less investment.* Less capital—in such forms as barns, factories, fruit trees, locomotives, trucks, tractors, machinery, steamships, etc.—would be produced. But unless we predicate depression, other things, for a time, would be produced in greater quantity.[8] If citizens wanted chiefly consumers' goods and services, it is these that would be more largely produced. But if citizens wanted, most of all, *liquidity,* and so hoarded money, *gold for coinage* would be more largely produced. Or, if we are considering a single country and one having no significant gold deposits, gold for coinage would be *imported.*

The hoarding of money, if considerable, would of course have a tendency, other things being equal, to bring the general price level down.

[7] Böhm-Bawerk, *The Positive Theory of Capital,* English translation, London, Macmillan, 1891, Book V, Ch. II, especially pp. 250–1.

[8] Unless and until the shortage of capital instruments becomes serious enough to prevent this.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

But unless there were a rather rapid increase in liquidity preference, average prices would decline but slowly. And circumstances might be such that they would not decline at all. For the conditions in the gold mining industry or in the trade balance with the rest of the world, or both, *might be* such that, were it not for this hoarding (because of liquidity preference), there would be a tendency for the price level to increase a bit. But the hoarding, we may suppose, as the "marginal efficiency of capital" came closer to the zero point, might be indulged in by more and more citizens. In consequence, even though the general price level did not decline absolutely, it might decline *in relation to* the cost of producing gold or to the price level in other gold-standard countries.

Other things equal, a fall of average prices in a gold standard and gold producing country would encourage the mining of gold which could be minted into coins that would buy more than previously. Also, a price level decline in a country would encourage the peoples of other countries to purchase goods in the country where prices were thus falling. Or, if prices did not fall absolutely but did fall *in relation to* prices in other gold-standard countries, where prices were *rising,* the peoples of these other countries would tend to buy more from the country where average prices were rising less or not at all.

Gold would, therefore, be produced in and/or would flow into the country and would be minted into coins. This increase in money could mean, then, that the increasing desire to hoard would be fully satisfied and yet the increased amount of money would sufficiently compensate for its decreasing velocity of circulation, to prevent the price level from falling. Any decreased employment in the constructing of new and additional capital, due to liquidity preference, would be offset during the transition period, by *increased* employment in the production of gold *or* by *increased* employment in the production of goods to be exported in payment for foreign gold, or by both of these. If so, "liquidity preference," even though the "marginal efficiency of capital" were to come fairly close to zero, need not decrease the price level, or the effective demand for labor, or employment.

But equally satisfactory results would be obtainable, if monetary sense were used, without the necessity of producing gold at home at great cost in labor or of buying it in quantities abroad at high cost in terms of exports and, therefore, of work. Predicating, of course, determination to avoid any significant—and objectionable—price-level inflation, additional money could be paid out by goverment, sufficient to offset any liquidity preference which might otherwise bring the price level down

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

and precipitate depression. Or the government could pay out checks on the Federal Reserve banks, which would be backed by a special issue of government paper money eligible—like gold certificates—as reserves for the Federal Reserve banks. Some of the purchases of goods and services by government could thus be paid for with this new money—or by checks on the Federal Reserve banks—instead of with money secured through government taxing us or borrowing from us.

In other words, instead of performing labor to produce gold or to produce extra goods with which to purchase gold from abroad, some of us would be performing important services for our own government. For the performing of these services we would receive additional circulating medium. The desire for liquidity would thus be satisfied, but without any diverting of labor into the production of gold or into production of goods to be shipped abroad in payment for gold. Or the new circulating medium might be paid out in redemption of a part of the national debt.

Obviously, if only a small increase of circulating medium were needed for the purpose, Federal Reserve action alone would suffice. But we are considering here the question whether even a great increase of demand for liquidity, due to (say) a considerable lowering of the "marginal efficiency of capital," must necessarily lead to business depression in a private enterprise system.

For the contention seems to be that,[9] even in the absence of any business or price level fluctuation from unwise monetary—including banking—policy, the returns on capital might possibly become so low, conceivably less than enough to cover depreciation, that many recipients of money would hold it indefinitely rather than invest in productive capital. If *no gain at all* could be realized from investment in buildings, machinery, steamships, etc., and especially *if there were an average loss,* one who wished to provide for the education of his children or for his own old age, would do as well or better just to lay his savings aside in the form of money (assuming, of course, no inflation) until such time as he might need them.

But such a condition, *with* wise control of the volume of circulating medium, would not tend to bring business depression. If so much money were hoarded as *really* to threaten significant reduction in the demand for goods and in the general level of prices, a wise monetary policy would provide for the issue of enough additional money (and/or bank credit) to maintain the price level. This would mean that the demand for goods in general at this level would *not* decline, for such decline would bring

[9] See my *Basic Principles of Economics, op. cit.*, Vol. II, pp. 176–7.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

the price level down. A sufficiency of money to maintain the price level would, by that very fact, be a sufficiency of money to maintain the demand for goods in general. Hoarders laying aside money for future use could be permitted to do so freely, yet there need be no disrupting decrease in the demand for goods and labor. Obviously, though the uncomprehending may deny this, there will be some limit to the amount of money wanted for hoarding. For each hoarder would naturally *apportion* his available money (or money and bank deposits subject to check) between his current needs and his anticipated future needs and neither would nor could hoard all of it.

Capital is productive but its marginal productivity—what one final increment or unit of capital can add to output—decreases as the amount of capital in relation to labor and land increases. And thus it could *conceivably* happen, as just assumed, that a widespread and continuing spirit of thrift would so increase the amount of capital as to bring its marginal net productivity rate and, therefore, the rate of interest, close to the zero point or even below zero. However, as the marginal productivity of capital approached zero, an increasing number of persons would begin to show a preference for keeping their savings in the form of money—or of gold, platinum, silver, diamonds or other valuable and easily stored commodities not subject to appreciable physical depreciation. And so there is some reason to doubt that the average net marginal productivity of capital would ever go below zero or, even, quite to zero, no matter how widespread the spirit and habit of thrift might become.

But it may be said by some objector that we cannot trust our government thus to issue new money lest it issue this in excess.

The fact is, however, that to avoid the evils of periodic severe depressions and to maintain a reasonably stable level of prices, we must have, somewhere, effective control of the volume of circulating medium.[10] If we cannot hope to trust our government or to have, ever, a government that can be trusted to do this (and, therefore, a public opinion that will consistently allow such a policy), there may be considerable reason for despairing of the future of the system of free private enterprise.

It perhaps should be emphasized that the policy here suggested is certainly not one involving price regulation or socialistic regimentation. It does not involve government operation of any industry. In essence it is analogous to, if not practically identical with, the establishment of a standard pound, a standard quart, a standard yard. Since the dollar is a standard of value applicable to all goods and services that are subject to

[10] *Ibid.*, Vol. II. p. 32.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

purchase and sale, the stability reasonably required is stability in terms of goods in general rather than in terms of any specific commodity, whether gold, platinum or silver.

Varying conditions affecting the production of specific goods may cause one commodity to rise in price at the same time that another falls. If we maintain free private enterprise and free markets, the dollar cannot be stable in terms of each and every specific article or service. But it can be kept stable, or approximately stable—*if there is the will to keep it so*—in terms of its average purchasing power, *i.e.,* in terms of the purchasing power of $100 or of $10,000 or of $100,000, over a typical composite of goods. And just as it is conducive to the smooth and efficient operation of a private-enterprise free-market system that the yard should be of calculable length rather than varying unpredictably between twenty inches and fifty inches, so likewise does it conduce to the smooth and efficient operation of private enterprise, that the dollar should be of calculable and stable value.

IV

IF NEVERTHELESS some readers are *shocked* at the idea of taking care of any liquidity preference that might conceivably tend toward depression, by increasing the money supply, they may be comforted by two considerations. The first is that returns from capital do not now seem to be so low as to indicate any probable threat from liquidity preference, as such, in the immediate future. And the second is that there is available a very simple policy *completely ignored by Keynes,* by which, even if otherwise the "marginal efficiency of capital" to the owners of it could drop to near zero in (say) a generation or so, we might enjoy at least a *reprieve* for several years beyond that, maybe for a second or third generation or longer!

Before identifying this policy, it will be advantageous for us to note that "the marginal efficiency of capital" for the entire community or for the nation as a whole, is, under existing conditions, decidedly greater than for an individual owner or all private owners. A capital instrument may yield—its productivity may be—8 per cent a year over the amount necessary to cover depreciation. But the owner—or the lender—cannot keep this for himself. The community, state and/or nation will require a large proportion of it in taxation.

If taxation takes 3 per cent of the 8 per cent, the owner can have but 5 per cent. Let us suppose that investment in capital were actually so much increased in two or three decades as to bring the average yield of capital to its individual owners down to only 1 per cent. This would

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

mean that the capital was still really yielding 4 per cent but that taxation was taking three fourths of that. On the supposition that investment would go on only to the point of a 1 per cent return for the investor, we would say that at that point the influence of "liquidity preference" was sufficient to prevent any further investment. The total yield may be high enough to encourage investment, perhaps for many more years or even generations, but the yield after taxes is not. Or if investment would go on only to the 2½ per cent point for the investor,[11] the existence of the 3 per cent tax would make it stop at a total per cent yield of 5½ per cent.

If, however, the tax—or taxes—were repealed and the revenue lost were made up by a much higher tax on the annual rental value of land, the entire per cent yield from capital—whether 4 per cent or 5½ per cent or whatever—would thereafter go to the individual investor in capital. This decidedly larger per cent yield might well be a sufficient inducement to him to forget his desire for liquidity and continue to invest. And if so, it might still be a considerable time—whether a decade or two, or an entire generation, or far longer—before the per cent yield got to the point where increase of circulating medium was needed for the purpose of offsetting the tendency to prefer "liquidity" to investment. Maybe that point would never be reached at all!

So far as I am aware, however, *no* Keynesian has ever shown, in his writing, the *slightest* favorable interest in taking taxes off man-made capital instruments and levying, instead, heavier taxes on the value of land.

Even if, in the end, it were to turn out that we must still reckon with the threat of depression from liquidity preference, it would nevertheless be an advantage to have the large amount of capital that this tax reform would bring to the communities adopting it. As long, indeed, as the total "marginal efficiency of capital" (including the part now going to government at various levels) is above *zero, i.e.,* as long as an additional increment of capital will produce an excess over its cost of production, it is certainly an advantage to have it. Labor is better equipped with buildings, machinery, etc., and output per worker is larger. If, too, because of a higher land value tax, less land is held speculatively out of use, so that labor is *also* better supplied with good land, output per worker will be further increased. If, as Keynes seems to have believed,[12] at 2 or 2½ per cent above zero return additional investment is likely to be brought to a halt by liquidity preference, then it *has* to be true that tax relief for capital at that point or sooner, would be favorable to prosperity. And

[11] Keynes, *op. cit.,* pp. 218-9.
[12] *Ibid.*

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

cogent theory as well as significant statistical data[13] indicate that to make up the revenue lost, largely or entirely by a heavier land value tax would give a further fillip to prosperity.

V

THOUGH KEYNES BETRAYS no interest in increased taxation of community-produced land values, he does contemplate with equanimity and seeming approval[14] "the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital." This would come about, he suggests, via a State policy aimed at increasing the volume of capital "until it ceases to be scarce, so that the functional investor will no longer receive a bonus."

At least Keynes does not assert that, if no return at all from capital is allowed to the individual saver and investor, the community or nation will get, through private saving and investment, anything like as much new capital as in the past. He does not assert, even, that capital which is depreciated or obsolescent will be or would be replaced through such individual saving and investment. It would seem, then, that there could be appropriately applied to the Keynesian philosophy, the following criticism which, for years, I have been applying to Marxism.[15]

Isn't it fairly probable that a social philosophy which repudiates private enjoyment of any income from capital, *must* envisage having the State take over the function of constructing capital? And that it must envisage having the State determine how much is to be saved and compel the saving? At any rate, socialists certainly do not put their trust in any individual saving and capital construction but always contemplate control of saving and of capital construction, by the State.

This means, practically, that the State must own all capital and see that it is kept in repair. It means, also, obviously, that the State must direct the use of capital. As a result, the nation which accepts socialistic ideals inevitably accepts State control of industry. Even if such control were not inevitable in theory, all of us know that it would certainly be insisted on. The State becomes the universal employer outside of the control of which no economic life is possible.

It is well for us to understand why a government based on a socialistic ideology must be dictatorial in its relations with its citizens. Surely, in regard to saving and the construction of capital, there can be no alternative;

[13] *Basic Principles of Economics, op. cit.*, Vol. II, 129–36 (Ch. XI).

[14] Keynes, *op. cit.* p. 376.

[15] The next six paragraphs are taken from my book, *Basic Principles of Economics, op. cit.*, Vol. I, pp. 317–318. The first edition, containing these paragraphs, was published in 1942. They are reprinted in the 2nd edition (1947) and the 3rd edition (1955).

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

and socialists do not contemplate any alternative. Since individuals cannot be—and certainly are not—counted on to save adequately when they are not permitted to enjoy individually the fruits of saving, they must be compelled to save.

Such compulsory saving does not necessarily mean that citizens will be consciously aware of the compulsion. The government does not say to the individual: "You must save (say) twenty-five per cent of what you receive as wages." It merely sees to it that the citizen receives less money to spend. It publicizes a "five year plan," devoting, perhaps, a fifth or a third of the nation's annually available labor to the construction of capital.

Obviously, the labor that is devoted to the construction of capital for the use of future years cannot possibly be devoted to making shoes and shirts, to raising potatoes, cabbages and wheat, to picking apples and cherries and to baking bread. The more the labor of the people is devoted to constructing capital for the service of the future, the less labor can be devoted to the service of the present and the less the people can have to enjoy this year and next.

But in a socialistic State, the individual has no choice in the matter. Government decides for him and allows him, as wages, only what its central planning committee sees fit to allow. If this is not compulsion, what does the word mean? And are we perfectly certain that a nation can be organized for compulsion in this respect, with the government owning, operating, and increasing or decreasing at its pleasure, all productive capital, yet maintain in its individuals spontaneity, initiative, and a spirit of free inquiry and uninhibited criticism?

The clear logic of the matter, therefore, indicates not only that to relieve capital from taxation, so far as we can, by drawing heavily on the annual rental value of land, tends definitely to the strengthening of the free private enterprise system. The same logic indicates that to follow the opposite policy, *i.e.,* to abolish the tax on land and take by taxation practically all the yield of capital, must lead to the management of all or practically all industry by the State, with saving thereafter compulsory.[16]

The community or State which follows the first of these two divergent tax systems will have, because of it, less good land held out of use and more productive capital. Thereby its workers will be able to produce more and to earn more. Thus, although few of them, if any, are aware of the fact, a land value tax, *within the limits of what it can yield,* is more advantageous to workers than the most sharply graduated income tax.

[16] "Academic Freedom and the Defense of Capitalism," *Am. J. Econ. Sociol.,* 15 (January, 1956), p. 179.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms

And *this is true even for those workers* whose exemptions are sufficient so that they *pay no income tax at all.*

Keynesism is, obviously, closely related to—though not absolutely identical with—the economic philosophy of the Communist-dominated States, in its explanation of business depression and, to a degree, in other ways. The view of Rodbertus, Mummery and Hobson, accepted by Lenin and his followers,[17] that business depression results from inequality—that the workers, exploited by their capitalist employers, do not receive enough to buy what they have produced[18]—appears in Keynes with liquidity preference overtones. What the low-income groups lack the means to buy, the higher-income groups *could* buy—and here we include "investing" in buying—and sometimes, for a decade or more, do buy. But when capital becomes plentiful and its "marginal efficiency" becomes relatively low, their buying (especially in the form of *investing*) is, in the Keynesian view, so greatly reduced by liquidity preference, as to bring about vast unemployment of the workers and even loss for themselves.

Like the Communist-Socialist leaders who have followed the Marxist-Leninist philosophy, Keynesians feel that the evil is fundamental to a free private enterprise system. Like these, they think of it as inherent in the general nature of the system and not to be explained by anything so "superficial" as monetary instability. Like these, they seem to believe that periodic breakdowns are "inevitable" unless and until there is substantially increased collectivism. And like these, they appear to have no interest in distinguishing between private income from capital brought into existence through individual saving and investment, and, on the other hand, income from being in a strategic position to charge others for *permission* to work on, to live on, and to draw subsoil deposits from, those parts of the earth which have become desirable because of geological forces and community development. Or, if they do have any such interest at all, they seem to be—at any rate Keynes seemed to be—*more* critical of private enjoyment of income from capital than of private enjoyment of the rent of land!

Could it be that the interest and support—often the enthusiastic support—of "the Keynesian revolution" in economics is to be explained (1) by its having avoided any admission that land-value taxation is in any way desirable, and (2) by its having coincided with a substantial, and world-wide, trend towards collectivism?

Franklin and Marshall College

[17] Robert L. Heilbroner says the view was "embroidered into the royal cloak of Marxist doctrine" by Lenin. See *The Worldly Philosophers,* New York, Simon and Schuster, 1953, pp. 186–91.

[18] See, for an analysis and criticism of this theory, my *Basic Principles of Economics, op. cit.,* Vol. I, pp. 124–30; and for an analysis and further criticism of various "modern" modifications or overtones of it, see Vol. II, pp. 155–82, including footnotes.

This content downloaded from
149.10.125.20 on Thu, 20 Jan 2022 16:46:35 UTC
All use subject to https://about.jstor.org/terms