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FREE ENTERPRISE AND THE MANAGEMENT OF THE PUBLIC DEBT

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Chairman of the Falk Foundation Committee on the Management
of the Public Debt

A LITTLE over a year ago, I was persuaded to be chairman of a committee to study the public debt. We gathered together a group of people who, we thought, knew a good deal about it and we farmed the job out, asking Mr. A to write a paper on interest rates and Mr. B on the banks, and so on.

We have issued, so far, three studies. Most of you, I think, have seen them; if you have not and want to, write to my office and we will send them to you. They deal with the history of the public debt, a chapter written by General Ayres; "The Public Debt and the Banks", written by Roy Reiersen of the Bankers Trust Company; and "The Public Debt and Interest Rates", written by James O'Leary, Professor at Duke University. There are three more coming. One is in the press—"The Public Debt and the Insurance Companies". Another is now being labored over—"The Public Debt and the Budget", which is a very live topic. The sixth will be our conclusions.

I had a selfish motive in accepting the invitation to speak to you this morning, because I thought that by trying to outline to you some of the conclusions that seem to me to arise from the facts as we have assembled them and analyzed them, I might get some reactions and find out whether our tentative conclusions would stand up.

Therefore, what I want to give you today are a few tentative conclusions, particularly as they relate to the American system of free enterprise as we have known it.

It is called "Free Enterprise" in the program. I suspect that is an invitation for somebody on the program to point out

that free enterprise is not free and has not been free for many, many years. I shall not respond to that alluring invitation, but take it as it stands and talk about the debt in its relation to enterprise.

The United States is worried today about the public debt. The fact that the Senate has insisted that there should be a certain retirement of the debt is an indication of a good healthy concern. We need, however, to examine that concern and see that we are bothered about the right things and that we do something about them.

I think most people's concern about the debt is a little vague and nebulous, as we in fact found our own ideas were when we tried to set them down in black-and-white type. We found we needed to dig deeper and to go behind the appearances.

Most of us, at first, when we think of that towering 260 billion dollars of debt, have some fear that that great structure is going to fall down and crush us at some point; that somehow there will be a repudiation of the debt, or that the time might come when the Treasury, with its 55 billion dollars of issues that mature within a year, might find a market that was not receptive to the rolling over of those issues, and then might run into some kind of terrible jam.

As you analyze the matter, probably neither one of those fears is justified. The real danger of the debt is something much more subtle than that and something that relates itself more nearly to our system of enterprise in this country.

The real dangers of the debt seem to me, on analysis, to be two. The first is that it dilutes the money supply—inflation; in other words, you increase the money supply faster than you increase the amount of goods to be bought with it and prices rise. The dollars look like the same dollars; they are printed in the same way, but they are not the same. They are not as powerful dollars; they do not buy as much as they did before; and, of course, that process distorts the whole economy. It means a price rise so far of some 50 per cent above pre-war level as measured by the indexes. Probably it is more than that when you measure it in terms of our individual lives as we go about and try to spend these diluted dollars. That is the obvious consequence that has impressed itself on us.

The second is less obvious but even more subtly dangerous, and that is the effect of the debt upon enterprise. That effect,

I think, we may phrase as the effect in strangling or in smothering enterprise. How does it do that? In three ways. In taxation, obviously. We know that the present tax burden ties up enterprise, keeps people from going forward with things that they would like to do. It may not look like that today, because we are still living on that bulge of spending and of deferred demand that was the natural result of the war period; but we know that new undertakings are hampered at every turn by a tax system that puts a penalty on every additional bit of effort that a person may put forth. He is not compensated for that additional effort, except by ten cents on the dollar or something of that sort, while his risk remains one hundred cents on the dollar.

Freezing Interest Rates

The second handicap to enterprise that arises from debt—and this may not have occurred to you in these terms—is the freezing of interest rates. With a huge interest burden, five billion dollars in the coming fiscal year, according to the President's estimate in his budget message, there is every temptation for the Treasury, for the politician, for anybody who feels the tax burden, to say, "Let's keep the interest rates at the lowest possible point; let's freeze them there." One must concede that a great deal has been done in that direction; that the interest rates are lower than they have ever been before in this country, or ever before in any country in the world for any marked period. That decreases the burden of the debt as far as its carrying charges go, but it affects the interest rates on every operation in the country—on all bonds, on all loans. It sets a whole new pattern, and will, as long as those controls exist.

How does that interfere with free enterprise? Though it may be a little old-fashioned, our committee believes that interest rates have an economic function to perform: that interest rates are a mechanism for adjusting the supply of savings to the demand for those savings in the form of investments of various types. If you decrease the reward to the saver, at some point you find those two things do not mesh.

There seems to be plenty of money available now. Most of it is really not saved money. It is created money, inflated money, so that you do not get today a true test of the relationship between money saved and the need for money.

There is another very important function that interest rates have, and that is as a means of placing some restraint on the movements of inflation and deflation, on the business cycle, if you will. There, again, is an old-fashioned phrase. When we talk about the business cycle today, everybody just says "full employment". But they also say, "We mustn't have a depression." Well, interest rates—and what goes with them in the form of credit control—are the long-accepted method for placing some check on the fluctuations of the business cycle.

There were, of course, many times when the method did not work well. In 1929, when we tried to stop a boom by raising interest rates, it did not stop the boom very quickly. In the thirties, low rates did not seem to stimulate business. If you go back, however, into the periods of the past, into the long years of history of the Bank of England, into what happened in this country in the twenties, you do find that credit controls through the central bank have operated at times with extraordinary effectiveness as a means to check booms and to lighten the burden when the depression comes.

People do not talk very much about that today. They talk about other methods of dealing with the swings of business and trying to stabilize them. They talk about the compensatory budget. A whole philosophy has been built up on that, in minutest detail. You find books about it that tell you just what to do under different circumstances. But nobody has ever tried it, except on a very minor scale. There may be something in it, but at least we must say that at the present stage, it is almost wholly a theory, and its application rests on decisions by the government and by the Congress particularly, because Congress will not hand over to anybody else the decisions as to how much to tax or how much to retire debt this year or how much to spend.

There are other methods that have been suggested to deal with the cycle: for example, qualitative credit control. The Federal Reserve Board has suggested that it should be given more power in telling the member banks how much short-term governments they ought to have in their portfolios and just how they should behave themselves as far as making installment loans to individuals goes. Well, there are many people who do not think that would work very well, either.

But why should we throw overboard completely the only method which, over a long period of years, has at least demonstrated some soundness and some capacity? That is the argument against freezing interest rates.

There is nothing as damaging to our system of free enterprise as great swings of the cycle with no method of modifying them. We do not want a system of individual controls of business. When the bureaucrat reaches his hand out and tries to tell people just what to do, it does not work very well. We have found from experience, however, that central banks with their influence on the quantity of money can exercise an influence on the cycle without reaching their hands in and telling everybody what to do. It is a more democratic way of doing things. It is more consistent with our system of free enterprise.

But to make that influence effective, interest rates must not be frozen. There must be some fluctuation of rates, partly as an instrument of itself in the form of changes in discount rates, partly because, when you do things to tighten up credit like selling bonds, that also affects rates.

Here, then, is the second way that this huge debt, with its huge interest burden, may interfere with the system of free enterprise: by freezing interest rates. It keeps them from performing their proper economic function.

The third way is that the huge debt tempts the government to undertake more control over our economic life than it would otherwise. I have already referred to the control through taxation, and the qualitative control of credit. When the government is spending a large amount of the national income, the temptation to put in controls becomes more and more inviting, and the danger is that there may be set up a series of controls under which free enterprise cannot operate.

To summarize, therefore, what are the economic effects of the debt as they concern our system of free enterprise? First, it dilutes the dollar; second, it has a powerful tendency to smother and strangle enterprise in these various ways.

A Debt Program

Now, I would like to suggest the kind of program for dealing with the debt that would seem to have some promise of giving our free-enterprise system a chance of dealing with this towering debt of 260 billion dollars. First on any program in dealing

with the debt is the budget, because the budget is, after all, the place where all of these things meet. The budget, as the President presents it, is a composite of spending and of taxes and of debt retirement, and the problem in the budget is to get a correct balance among those parts.

Obviously, the present budget is out of control. Thirty-seven and a half billion dollars is too big. It is thoroughly inconsistent with maintaining the sort of enterprise system in the United States to which we have been accustomed. It will mean that the government spends 25 per cent of the national income; that much of the income has to be piped through the bureaus, through all those narrow little pipes that squeeze it as it goes through. It is too big.

With the thirty-seven and a half billion dollar budget, it is contemplated that there should be no reduction of taxes, no relief of the wartime burden that was put on as a temporary method of meeting wartime demands. The budget as originally presented allowed only 200 million dollars for reduction of the debt; in other words, it made no real beginning at reducing the burden of the 260 billion dollars. That is not a realistic budget, but can we do any better?

Cutting the Budget

We must recognize that the President and the Secretary of the Treasury and the Budget Director made a vigorous attempt to bring that budget down. They did bring it down from a very much larger figure. But would anyone of us say that that budget was sacred and could not be reduced further, that there was no remaining fat, no remaining waste in the government, that could not be cut out?

We have been studying that and we believe there are very large areas for saving. The Congress has been debating whether they can cut that budget by four and a half billion dollars or by six. A cut of something like that is attainable if the effort is made.

It is very far from easy. The budget is not something that only the President and the government departments decide about. They do not have the authority to make all the decisions. In the main, they are engaged in carrying out the laws that are on the statute books, and many of those laws are very wasteful laws and involve a whole series of subsidies to pressure

groups built up over a period of fifteen years which the American people, if they really laid them on the table and surveyed them, do not want.

The only satisfactory way you can cut this budget is to change some of the governmental policies, some administrative but many embodied in laws on our statute books. The whole veterans matter has been handled with incredible waste; in a great burst of generosity that did us all credit, we adopted legislation, much of which is thoroughly wasteful and picks out some people for favoritism and outright graft.

Here is the fact that two thirds of the patients in veterans' hospitals are people suffering not from service disabilities but from some other disabilities. I could go into a veterans' hospital because I am a veteran of World War I, and if I were willing to certify that I could not afford to pay for the service in other ways, there is a bed waiting for me.

Several hundred million dollars in the budget for building new hospitals are predicated on the fact that they are intended to give service, not to veterans disabled in action, whom, heaven knows, we must take care of, but to you and me and other veterans who are willing to say we cannot afford this service some other way. In other words, it is just a long step toward socialized medicine without that label on it.

One could point out other things of that sort; but they are on the statute books and the only way you will get them changed is by changing the policies. So this business of dealing with the budget, of cutting it down to a size where we can deal with it, is not something you can do just this year. We can make a start, but to deal with it adequately is a work of a good many months and a good many years. It must be done, however, if we are going to deal with the debt in such a way that it does not interfere with our system of free enterprise.

I am tempted to say a word about the new proposals in foreign policy, in their relation to the budget. One wonders whether that means a huge additional body of spending. I do not believe that it does. This Greek and Turkish aid ought to be given and given quickly. It is part of the negotiations that are now going on. It is an indication of America's will to play its part in the world. But I think, when you analyze other situations and the whole picture, you find that this is a relatively unique strategic point.

We cannot undertake in America to feed everybody who says he would like some food and to pour out our money to everybody who would like it. We have not the resources to do that. We cannot feed the entire world. To the extent that we force it on people, we weaken the fiber of their own capacity to rise. After all, they themselves, mostly by their own efforts, have to pull themselves out of the internal troubles in which they find themselves. They need help but the help must be administered wisely and strategically if we are to fulfill the duty which falls to us.

My own belief is that the instruments that we have already created, plus certain strategic loans such as these to Greece and Turkey, will accomplish the purpose. The new International Bank is getting itself geared up to do its job and do it in a very effective way, in a way that will help people to help themselves. We ought, in area after area, rather promptly, to reach the stage where that gap can be bridged by the World Bank. Then, from there on, private enterprise, private loans in this market, and American business going through the world can take up the burden.

I do not really believe a sound foreign program is going to stand in the way of dealing with the budget. To the extent that it does, I believe that we must be prepared to pull in our belts at some other points, to modify wasteful practices, to remove some unnecessary subsidies from the budget, so that we get it down to a size that can be dealt with.

Reducing the Debt

That we must reduce the debt is obvious. We must make a beginning on pulling down this huge amount so that the interest burden will be decreased and so that its effect on bank credit and on the whole economy will be diminished. The Senate, I think, showed a commendable spirit in insisting that there should be some measure of debt reduction. Whether \$2,600,000,000 is the right figure, I do not know; but at least it is the kind of figure that should be considered.

We are already making a beginning in reducing the debt. The figures look better than they did at first. We will run a surplus for this fiscal year, and we are even now paying back the debt. Some of it was just using the balances on hand to pay debt, but it has gone beyond that. We are making a reduction

particularly in reducing the inflationary bank-held debt. That is being done technically in various ways, using the proceeds of sales of savings bonds, the social security funds and so on. The trend is in the right direction.

Distributing the Debt

Another job is to distribute the debt. The damaging part of the debt, the most dangerous part, is the debt in the hands of the banks, because that is money. That stands for active bank deposits. That is the inflationary factor. In one way or another, we must pull that debt out of the banks and put it into the hands of investors, and that process is under way.

One of the best ways is through the sale of savings bonds. That is being done pretty effectively. The Treasury is launching a new program this summer. The "Buy a Bond a Month" sounds just like some more of the war sales, but, in reality, it relates itself directly to this whole problem of dealing with the debt, for the debt will be more manageable if we get it out of the floating debt class, if we get it out of the class that has to be dealt with every month as the maturities roll around, and put it away in the hands of investors, into their safe deposit boxes, into insurance companies and so on, where it is not in the money stream.

Reducing Taxes

Furthermore, we must reduce taxes. Roswell Magill, who follows me, will tell you just how to do that, so I do not need to pause very long to talk about it. From the point of view of dealing with the debt in such a way as to restore enterprise, I think one can say this: If you examine the history of the past, it is clear that, after every great war, the people who looked at their towering debt were discouraged about it. Macaulay wrote about it after the Napoleonic wars. You can find it in the literature of our own economists after the Civil War, and certainly after World War I. They said, "How can we ever deal with this huge debt?"

Well, in England and the United States, those problems proved not to be as difficult as they were expected to be, and the reason was that the forces of enterprise carried forward so vigorously that the national income was increased and the debt became smaller and smaller in relation to the income.

I noticed Sumner Slichter published an article the other day in which he predicted that by 1960 the national income of the United States, if we were sensible about things, might be three hundred billion dollars. Well, that is a thing one ought not to let himself dream about, because it might give him nightmares; but at least it suggests that if we pursue sound policies that allow enterprise to have a chance, we can increase the volume of business and increase the income of the average family to a point where a \$7,000 debt (and that is the size of the debt per family) ceases to be so great a burden.

If you were to go through the whole range of things that could be done to release the dynamic forces of enterprise, certainly cutting of taxes is the most important, as anyone will certify who is in business in any form; and the tax cut should be directed to the place that will help the small and the growing business. What tax is that? It is the tax on individual incomes because most small business is unincorporated. It is the tax rate on individual incomes from five to fifty thousand dollars or a hundred thousand dollars that makes it extraordinarily difficult for the small business man—the fellow who, coming up from the grass roots, has always stimulated things in this country—to make progress, to build up those reserves that he needs to go forward with enterprise.

I will leave the rest of that discussion to Roswell Magill, except for one point. There is a difference of opinion among the economists about just when you should cut taxes and, in particular, there is a certain suggestion of contradiction in cutting taxes at a time of inflation. I hope Mr. Magill will take up this point and tell us all about it. It is argued that taxes are repressive; we have inflation; therefore we ought to keep taxes high. There are several difficulties about that.

One is that, as a matter of fact, taxes are to a certain measure inflationary. Look at it in wages. If you have an individual tax cut, it becomes less necessary to increase wages. It becomes easier to reduce prices. Those are two of the things that we want to do, so that, to that extent, a tax cut is anti-inflationary.

In the second place, you cannot time these things precisely. It is the old problem of whether a compensated budget can be made to operate. The Congress is now acting on the taxes that we will be paying six months and a year from now, as well as right now. What will conditions be six months and a year

from now? Some people say we will be sliding into a depression. Well, if that is true, you need all the stimulation of enterprise that you can get. But we cannot time these things with precision. You have got to do some things in relation to the longer trend rather than in relation to the immediate situation, as you interpret it. We do not always know with complete precision just what the situation is today—not to say six months from now.

The third difficulty is a very human consideration. People want a tax cut very badly. They are justified in wanting one. They have been through the war period. They have carried a heavy burden. It is a perfectly legitimate human requirement that we should move away from some of these wartime restrictions and restraints, and it is wholesome to do so because we do not want to get them fastened on us.

Unfreezing Interest Rates

Another step in a debt program is to unfreeze interest rates. I have already talked about that, in discussing the difficulties that would arise, and I shall not dwell on it. I am not arguing necessarily for an increase in rates. I am arguing for stopping the commitment that rates shall remain at some given point. You need a little uncertainty in the situation, and I speak there as an old central banker. If the central bank is going to have any influence on the flow of the business and money, it cannot go into action with its hands tied behind its back. So let us get away from the freezing commitments and leave the central bank a chance to act and give rates some chance to perform their economic function.

Improving Government

Finally, to deal with this debt wisely, we must somehow improve the quality of our national government. Whether we like it or not, the government is going to be bigger than it was. Its budget is going to be very large for a long time to come. A larger proportion of the national income will flow through the government. The government will be doing a great many more things than it has in the past. That is at the will of the people. Therefore, we cannot get along with the same standards of government competence that we have shuffled along with for a long time in the past.

Some of you may have tried to get something done in Washington, just after a change of administration, and you wander around the empty corridors, wondering where you can find somebody who knows something about the problem that you are concerned with, for the whole layer of executives has been swept out. In other words, we have lacked that adequate group of high-grade civil servants who would carry on in a bipartisan way. I say we have lacked them. That is not a fair statement. There have been notable exceptions of outstanding men who have served the public. We started at one time to have undersecretaries who would be permanent. The first one, one of the notable illustrations, was Parker Gilbert in the Treasury, who did, in fact, serve for a time under two administrations, and then that trend was broken.

But if we are to have to deal with this huge budget and this huge debt, we must give greater attention to competence in our national government, all along the line. That means that we as citizens must be readier to direct our own sons and daughters into the service of the government and not leave such service to anybody who may come along; that we cannot shun politics and turn our back on it because it is a "dirty business". There is no single answer. I think we must pay higher salaries to our high-grade civil servants in that middle layer and give them better pensions and more honors. The knighthoods and the orders that they have in England have been a very helpful thing in stimulating public service. I do not advocate that we adopt that in this country, but I do think we need somehow to find the equivalent for our public servants.

These steps, which I have outlined, are essential parts of the program for dealing with the debt: to control the budget, to reduce the budget, to distribute the debt, to reduce taxes, to unfreeze interest rates, and to improve the quality of government.

The American people are more conscious of the problem than ever before. I do believe that if we take some intelligent action on these fronts, we can restore and carry forward the American system of free enterprise.

REMARKS BY THE CHAIRMAN

CHAIRMAN MORGAN: Thank you, Dr. Burgess! You have just listened to a broad survey of a complicated and difficult question. It was done with clarity and, as we all expected, with persuasiveness.

In Washington is the Brookings Institution. It is not only an institution for economic research; it is an institution for the examination and formulation of policies. In that way, it serves a very useful function.

An important member of its staff, Dr. A. D. H. Kaplan, is our next speaker. Dr. Kaplan is a native-born son of the state of Colorado. Recently he has been working with the Committee on Economic Development, at the head of a staff preparing a monograph on the financing of small business, a topic closely related to that which has been assigned to him for our meeting this morning—"The Rôle of Small Business and Free Enterprise". Dr. A. D. H. Kaplan!