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A PROFESSOR'S PROGRESS

A review of Economics, An Introductory Analysis, by Paul A. Samuelson, Professor of Economics, Massachusetts Institute of Technology Fourth Edition, McGraw-Hill Book Company, Inc., New York (1958).

An excellent binding with good reproduction of type and charts combine to give this book the appearance of a scientific treatise. Unfortunately, readers who therefore assume that it offers the last word in scientific economic analysis will be seriously disappointed. Still included in this fourth edition are major flaws that were among the reasons for my comment on an earlier edition, "* * * that such a book should have the implied stamp of approval of the Nation's leading scientific institution is a tragedy; in a sense it is a betrayal of intelligence in the modern world."

Before the reasons for such adverse criticism are described, Professor Samuelson should be commended for the marked improvements in this edition. In contrast with the earlier edition we reviewed, this volume does include some charts that show the long-term economic growth of the United States. Therefore, student readers at least have evidence that economic growth proceeded rapidly for decades before the creeping inflation advocates developed their modified version of the Keynesian spend-for-prosperity notions.

That the charts do not include years prior to 1890 is unfortunate. From 1875 to 1890, gradual deflation of the Civil-War and post-Civil-War inflation was reflected in a 40-percent decline of commodity prices; yet the Nation's economic growth persisted at a rate not subsequently equaled. With that picture in front of them, even sophomores might question Professor Samuelson's apparent predilection for creeping inflation as well as his assertion, "If price increases could be held down to, say, 2 per cent per year, such a mild steady inflation need not cause too great alarm." (p. 270)

Incidentally, although Professor Samuelson himself evidently disagrees with the assertion quoted above, as will be noted shortly, it reflects an advance from his position a few years earlier when he said, "* * * such a mild steady inflation [a rise in prices of 5 percent per year] need not cause too great concern" (p. 302, second edition). To the casual reader the difference between 5 percent and 2 percent may not seem important, but from the viewpoint of anyone who would live under those conditions the difference is striking. At 5 percent per year, a dollar's worth of life insurance or funds for a retirement pension would decrease in 60 years to a little more than 5 cents worth, a loss of nearly 95 percent of one's life insurance and pension funds; but at 2 percent per year, the loss would be much less, only about 65 percent.

When one views the matter considering the amount that would be left after prolonged creeping inflation, the significance of the Professor's progress is seen to be even more striking. Now that he approves of 2 percent rather than 5 percent per year, he is implying, in effect, that the buyer of life insurance should be permitted to have 35 cents left of his dollar instead of only 5 cents. Surely this sevenfold increase in what is left for the victim of creeping inflation is a gratifying change. Professor Samuelson may yet come to believe that life-insurance buyers should not have any of their savings "embezzled" by the subtle processes of inflation.

Professor Samuelson offers no purportedly scientific or economic explanation for the change from 5 to 2 percent. The only apparent hint as to the reason for this important shift is his concern about the rise in American consumer prices since 1900. He asserts (p. 5) that modern nations must "worry" lest total national income and money spending be too much, "thus creating general price inflation." Presumably as an example of the need for this "worry," Professor Samuelson also presents a chart on this page (Figure 1) accompanied by the comment "* * * we interpret the latest year's figure of 352 to mean that prices have gone up three and a half times, nearly quadrupling, during the life of a sixty-year-old." What would the Professor answer if some inquisitive sophomore in one of his classes asked, How does it happen that, on page 5, a prolonged rise in prices averaging about 2 percent per year is evidence of what nations should "worry" about; but on page 270 we are told that "* * * such a mild steady inflation need not cause too great alarm"?

Although I did not find in this volume Professor Samuelson's justification for creeping inflation, he perhaps would argue as does Professor Slichter of Harvard that "* * * creeping inflation is part of the price we must pay to achieve maximum growth."[1] American economic developments from 1875 to 1890 suggest that such an assertion was not true then, and no one has provided scientifically based proof that it is true today. West Germany's experience since regaining the prewar level of output in 1950 also casts doubt on the creeping inflation theory. From 1950 to 1955 industrial production in West Germany increased 79 percent; but in Sweden the increase was only 15 percent, although the rate of creeping inflation there (measured by the rise in the cost of living) was about 3 times that

[1] Sumner H. Slichter, "Current Trend, Problems and Prospects in the American Economy," *The Commercial and Financial Chronicle*, February 19, 1959 (p. 3).

in West Germany.

Perhaps the most convincing argument against the creeping inflation theory of inducing maximum economic growth is found in the fact that inflation makes possible an excess of dollars chasing goods, which in turn provides windfall profits for many businesses including some that in the absence of inflation would incur losses. When inflation occurs, businesses that otherwise would fail or at least curtail output and release factors of production (men, capital, and natural resources) for transfer to the growing industries are enabled to remain in business with a resulting delay in the shift of resources to more rapidly growing industries. Change, not creeping inflation, is the price of economic growth; and experience suggests that change is inhibited and delayed by inflationary prosperity.

Dr. Samuelson's recognition of what he calls the "miracle" of West German postwar economic developments is encouraging to those who hope that his progress will continue. He describes the basis for the "miracle" as "a thoroughgoing currency reform" (p. 38), which seems an inadequate description of reforms that restored free markets as well as a redeemable currency, and, in effect, tossed into the discard the depression panacea Professor Samuelson evidently favors. Would it not be worthwhile in an economic textbook to devote more than a few lines to the experience of West Germany in recent years? Surely an economic "miracle" merits more detailed comment, especially when such consideration would reveal so much about significant aspects of American foreign and domestic economic policies.[2]

Many writers of economics textbooks have given only superficial consideration to the potential effects of a tax on site values as differentiated from a tax on value of improvements. In a brief but clear discussion of this point (pp. 529 and 530) Professor Samuelson describes how a tax on site values would fall in its entirety on those privileged to hold exclusive titles to such sites and would not burden either those who labor or those who invest in the reproducible capital of our economy. An obvious conclusion is that shifting of the tax burden from investors and earners would encourage new investment as well as the processes of production and would inhibit the speculative withholding of valuable sites and resources from production. That the net result could be more rapid economic growth with output more equitably distributed among those who participate in the productive processes seems equally clear.

The potentially far-reaching consequences of taking much of site rent for public uses might well have been discussed in greater detail. The Institute of Research of Lehigh University, another distinguished school of engineering, has analyzed and reported on the potential effects of exempting improvements and taxing only land values in the city of Bethlehem, Pennsylvania.[3] Here is substantial evidence that the slum areas of a city reflect prolonged unwise apportionment of the tax burden and that the simplest remedy for "sick" urban areas would be shifting present taxes on improvements to taxes on land values. Moreover the experience of Sydney, Australia, and several other cities indicates that even most of the landowners, surprising as it may seem, would benefit from such a shift of the tax burden. The experiences of Denmark, of New Zealand, and even of Pittsburgh, Pennsylvania, with its partial application of the principle, merit consideration by every student of economics.

So much for the evidence of some progress by Professor Samuelson. In other respects the lack of progress is evident.

At two points (pp. 5 and 21) he asserts that, during World War II, "American civilian standards of living surpassed all previous levels." Such statements frequently are made by economists enamored of the spend-for-prosperity notions, perhaps because their theories suggest that the vast monetization of Government debt should have had that result or perhaps because they are so naive as to believe that money incomes correctly reflect the standard of living. Here are the facts:

a. Production of passenger automobiles for civilian use during World War II virtually ceased. With reference to the public's huge investment in passenger automobiles, the standard of living greatly decreased as a result of wear and tear, depreciation and obsolescence, lack of replacements for vehicles scrapped, and lack of additional new vehicles to maintain the per capita quota.

b. Construction of new residential housing decreased 85 percent and remained at a low level until after World War II. Inevitably the standard of living with reference to housing decreased during the War for reasons similar to those in a, above.

c. A comprehensive index of production of new consumer goods per capita[4] shows that a 25-percent decrease in the production of all consumer goods occurred from mid-1940 to 1945.

d. In large part because automobiles, new homes, etc. were *not* available, individuals hoarded about $15,000,000,000 of their wartime wages in the form of currency and many billions more in the form of idle checking accounts.[5] In addition, many billions of wartime incomes were invested in U. S. Savings Bonds.

In view of these facts, civilian standards of living could not have reached unprecedented levels during the war years. To imply otherwise may suggest to many readers that monetization of deficits, i.e. inflation, somehow offers an easy route to perpetual prosperity.

When he attempts to discuss "money," Professor Samuelson gives his readers inadequate information. For example, what is meant by the words on a $10 bill, "The United States of America will pay to the bearer on demand Ten Dollars"? I could find no evidence in the Professor's discussion that he knows of this promise or its significance, in spite of his attributing West Germany's "miracle" to "currency reforms," a principal feature of which has been a sound currency now redeemable in gold on demand. Surely, differentiating be-

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[2]Melchior Palyi, *Managed Money at the Crossroads*, University of Notre Dame Press, Notre Dame, Indiana (1958), p. 100 et seq.

[3]Eli Schwartz and James E. Wert, *An Analysis of the Potential Effects of a Movement Toward a Land Value Based Property Tax, A Research Project Undertaken by The Institute of Research of Lehigh University*, published by the Economic Education League, Albany, New York, 1958.

[4]*Current Economic Trends*, Special Bulletin, June 1958, published by American Institute for Economic Research, Great Barrington, Massachusetts, p. 13

[5]Ibid, p. 6.

tween dollars (1/35 of an ounce of gold) and promises to pay dollars is elementary in any attempt to describe a money-credit system. The foreign central bankers who have demanded that such promises be kept in the past year, with a resulting loss to the United States of more than $2,000,000,000 in gold, have a clear understanding of the difference between promises to deliver something and the thing promised. Should not American students be equally well informed?

In discussing what he calls "Government transfer payments," the Professor asserts (p. 121), "Moreover, to the extent that taxes come out of the incomes of the more well-to-do and thrifty and are used to make payments to the needy and ready-to-spend — to that extent the total purchasing power is increased." Now, it is apparent that this statement can be correct only if, and to the extent that, the well-to-do would otherwise hoard the funds that the tax collector takes from them. In other words, Professor Samuelson has assumed, first, that the "well-to-do and thrifty" habitually hoard portions of their incomes and, second, that the well-to-do pay their taxes from such hoarded funds rather than by turning over to the tax collector funds that they otherwise would spend or invest (meaning, of course, spend for capital goods). It may surprise him to learn that the available records do not support his first assumption. That being the case, the only comment necessary regarding the second assumption is that, even if the first were correct, he would still have to prove his second to be correct before he would be warranted in offering his readers the assertion quoted above.

Even in elementary logic Dr. Samuelson stumbles. An example follows: after pointing out that savings bonds in the hands of the public are "* * * the other side of the social balance sheet which shows the government's liability," he says ,"If the public debt is a completely bad thing, then these family savings are essentially a bad thing; if these family savings are a good thing, then the public-debt cannot be as completely black as it is often painted." (p. 170)

To argue that the desirability or undesirability of debt depends on the desirability or undesirability of the invested funds or savings and in the same sentence to argue that the desirability or undesirability of the invested funds depends on the desirability of the debt in the evidence of which they are invested is to argue in a circle. That's the sort of reasoning Lewis Carroll used to puzzle Alice in Wonderland and decidedly not the sort of reasoning one would expect to have offered to students at M.I.T.

Some of Professor Samuelson's comments about free competitive markets are revealing. For example, he says (p. 37), ". . . a competitive system of markets and prices . . . is not a system of chaos and anarchy. . . . It functions. Without intelligence it solves one of the most complex problems imaginable, involving thousands of unknown variables and relations. Nobody designed it. Like Topsy, it just growed; . . ."

The phrase "without intelligence" suggests the typical viewpoint of many who favor a "planned" society, meaning of course one for which economic activities are planned and directed by a central agency where great intelligence, perhaps their own, is assumed to be available. Such a viewpoint as that reflected in the phrase "without intelligence" not only belittles the intelligence continuously applied by millions of individuals to their businesses, but also it in effect denies the far greater efficiency of that intelligence than any that a central planning agency ever has provided. The total effect of millions of intelligent individuals, each applying his intelligence in the areas he kows best, in solving the economic problems of a human society has proved to be more effective than the supposedly great intelligence of a central planning and control agency.

Professor Samuelson's comment that "nobody designed it" also is interesting. Has he never studied the basic economic plan for American society embodied in the Constitution of the United States? The system of nearly free competitive markets long established in the United States *was* deliberately designed by men applying principles subsequently expounded in John Stuart Mill's essay, "On Liberty" and other philosophical discussions of the basic principles embodied in the Constitution of the United States.

Another interesting point is the Professor's reference to Sweden. (Sweden has for some years been regarded by the Keynesian state planners and government interventionists as a nearly ideal country because of its, at first, seemingly successful application of semi-socialistic and spend-for-prosperity notions.) The reference is, "And a great economic statistician, Simon Kuznets of Johns Hopkins, has recently shown that the leading Western nations have for decades been averaging rapid rates of growth of output per head. How rapid growth? About 10 per cent per decade for France and England. About 16 per cent for Canada and the United States. And almost 30 per cent per decade for Sweden." (p 65).

To this reviewer, leading students to believe that Sweden is now exceeding or recently has far outpaced other nations of Europe and the United States in economic growth seems an inexcusable falsification of the record. Sweden's economy once was growing at the rapid rate indicated, but that was *before* the semi-socialist planners and spend-for-prosperity theorists gained a dominating influence in Sweden's government during the fourth decade of the present century. In the 1950's through mid-1958. Sweden's industrial production per capita increased less than one-quarter compared with nearly twice that rate in the United States and about four times Sweden's rate in West Germany.[6] Figures directly comparable to the 30 percent per decade mentioned by Professor Samuelson are not yet available for all of the 1950's, but that the rate of economic growth in Sweden has fallen *far behind* the comparable rates in much of Europe and the United States already is well documented.

In Chapter 12, Dr. Samuelson presents the familiar Keynesian notions with numerous charts and formulas. This chapter is entitled "The Theory of Income Determination," and the subject matter is presented much as a chemist or a physicist would write about an accepted theory in his field. There the resemblance ends, however. What Professor Samuelson offers is not a scientific theory but a set of hypotheses for which proof has not been provided between the covers of his book or

[6]These approximations are derived from *Monthly Bulletin of Statistics*, United Nations, December 1958, and the latest *Statistical Yearbook*, United Nations.

elsewhere. Unwary students may at first assume that the "theory" of income determination is like Einstein's theory of relativity in that adequate testing of the factual implications of the original hypothesis has elevated it to the scientific rank of a warranted assertion or accepted theory.

Professor Samuelson uses a diagram to illustrate in chart form imagined figures presented in a table and then asserts that the illustrative diagram can be used "to confirm what has just been shown by the arithmetic of Table 1" (the table of imagined figures p. 230). This is an unfortunate choice of language. Students are accustomed to using the phrase "can be shown" in the sense of "can be proved." When told that a diagram does "confirm" what a table has "shown," they may not realize that the Professor is saying, in effect, something like this: "These notions or hypotheses can be illustrated by a table of figures 'dreamed up' for this purpose; and the notions can be further illustrated by making a diagram using the 'dreamed up' figures."

The Keynesians generally have followed the outmoded procedure of judging the usefulness of a theory by its plausibility instead of by checking its implications against measured economic changes. In the realm of science, theory is controlled by the facts. When scientists find facts at variance with theory, that theory is discarded; but many Keynesian economists do not even bother to seek the measurements of changes implied by their theory. In this respect, Professor Samuelson is simply following the too long established precedent in his field.

Perhaps I should add at this point that in none of these criticisms have I intended to impugn Professor Samuelson's personal integrity. My point is that such out-of-date facts, such careless characterization, such mistakes in logic (of which I have mentioned only a few), and continued application of methods of inquiry now obsolete, render this textbook unfit for student assimilation.

Professor Samuelson claims (Preface p. VII and pp. 587-588) that he has achieved or is in the process of achieving a "neo-classical synthesis" that will join in fruitful wedlock classical economics and that portion of the Keynesian ideas deemed by Samuelson to be worthy of the union. If what Von Mises or Hayek, as examples of economists in the classical tradition, have written about the Keynesian ideas may be taken at face value, either would be decidedly reluctant to see his brainchild a "groom" at the "wedding" Professor Samuelson plans.

Moreover, the present writer's position is that such a "wedding," whether of the "shot-gun" variety or otherwise, would not be fruitful for the simple reason that both bride and groom, that is, the Keynesian notions and much of classical economics, are "dead ducks." My reasons for so believing have been discussed in detail elsewhere.[7] Here there is room for only a summary explanation.

The methods of conducting inquiries applied by the Keynesians and to a substantial extent by the classical economists were the older, now obsolete methods. Briefly, those methods included Aristotelian logic, introspection, what may be called secular revelation (a process at which Lord Keynes was especially adept), and the quest for certainty so long persisted in also by philosophers. Such methods give great weight to the internal logical consistency and general plausibility of an hypothesis but accord little weight to the desirability of testing its logical implications against measurements of economic changes before offering the hypothesis as a warranted assertion applicable to the problems of men.

That a revolution in methods of inquiry is well under way in the behavioral sciences, including economics, is obvious to anyone who will observe its consequences in several fields. This revolution is comparable to the Galilean revolution of three centuries ago in the physical sciences and to the similar revolution in the physiological sciences marked by the advent of graduate schools of medicine more than a hundred years ago.

Will Professor Samuelson continue as one of the last of the alchemist-economists, using as his model, Lord Keynes (whom Professor Samuelson on page 13 describes as "an all-round genius")? As everyone who recalls the discussions in economic journals during the 1930's is well aware, Lord Keynes escaped from every blind alley in which his economist critics nearly cornered him by the simple process of abandoning successive positions and dashing down other blind alleys. The verbal skill that facilitated his Houdini-like "escapes" was widely accepted as proof of his "brilliance" by those to whom the scintillating flash of words seemed more significant than the humdrum facts preferred by others who have rejected perpetual-motion theories and alchemists' dreams. However, following in Lord Keynes footsteps may not be practicable. Times have changed; the revolution in methods of inquiry proceeds with increasing speed; and an emulator of Lord Keynes may discover, as the alchemist professors did long ago, that the market for outmoded textbooks can rather suddenly disappear.

An alternative would be to learn as rapidly as possible and apply modern methods of conducting scientific inquiries in the behavioral field. This choice could in time make Professor Samuelson an eminent Faculty associate for the distinguished scientists at M.I.T. instead of the anachronistic pseudo-scientist that he now seems in the light of our present understanding of successful scientific method.

In spite of its flaws, this book seemed worth reviewing because it is the most widely used economic textbook today. Many of an entire generation of college youth are being indoctrinated with the Keynesian notions. Much evidence now available suggests that application of these notions has brought Sweden to the brink of disaster, all but ruined France, and greatly endangered the future of the United States, to mention only a few of the consequences. Resolute discarding of such notions, as was mentioned earlier, has made a vital contribution to the "miracle" of West German economic growth. In the light of these developments, the importance of teaching American youth scientifically warranted assertions instead of the doctrines offered by Professor Samuelson seems obvious.

E. C. Harwood

[7]E. C. Harwood, *Reconstruction of Economics,* American Institute for Economic Research, Great Barrington, Massachusetts, 1955, especially sections IV, VII, and XI.