The Public Debt Rises Under Roosevelt's Erroneous Theories

The inadequacy of this theory of the depression was shown in 1937 when the New Deal, after four years of pump priming and a victorious election in 1936, stopped its spending. Instead of taking off, the economy collapsed in the steepest recession in history. The New Deal had to resume its treatment of symptoms but now ... the spending program could [never] ... be ended, ... since the administration ... lacked the ... [determination] to reform the system or ... to escape from borrowing bank credit with its mounting public debt, and the administration ... [decided not to] to adopt ... [a] really large-scale spending necessary to give full employment of resources. The administration was saved from this impasse by the need for the rearmament program followed by the war. Since 1947 the Cold War and the space program have allowed the same situation to continue, so that even today prosperity is not the result of a properly organized economic system but of government spending, and any drastic reduction in such spending would give rise to an acute depression.

Chapter 36—The Economic Factors

From an analytical point of view there are a number of important elements in the economic situation of the twentieth century. These elements did not all come into existence at the same time, nor did any single one come into existence everywhere simultaneously. The order in which these elements came into existence is roughly that in which we list them here:

1. rising standards of living

2. industrialism

3. growth of size of enterprises

4. dispersal of ownership of enterprises

5. separation of control from ownership

6. concentration of control

7. decline of competition

8. increasing disparity in the distribution of incomes

9. declining rate of expansion leading to crisis

Rising Standards of Living

1. A rise in the general or average standard of living in modern times is obvious and, with intermittent breaks, goes back for a thousand years. Such progress is welcome, but it obviously brings with it certain accompanying factors which must be understood and accepted. A rising standard of living, except in its earliest stages, does not involve any increase in consumption of necessities but instead involves an increase in the consumption of luxuries even to the point of replacing basic necessities by luxuries. As average incomes rise, people do not, after a certain level, eat more and more black bread, potatoes, and cabbage, or wear more and more clothing. Instead, they replace black bread with wheaten bread and add meat to their diet and replace coarse clothing by finer apparel; they shift their emphasis from energy foods to protective foods.

This process can be continued indefinitely. A number of students have divided goods from this point of view into three levels: (a) necessities, (b) industrial products, and (c) luxuries and services. The first would include food and clothing; the second would include railroads, automobiles, and radios; the third would include movies, books, amusements, yachts, leisure, music, philosophy, and so on. Naturally, the dividing lines between the three groups are very vague, and the position of any particular item will vary from society to society and even from person to person.

As standards of living rise, decreasing proportions of attention and resources are devoted to primary or secondary types of products, and increasing proportions to secondary and tertiary types of products. This has very important economic consequences. It means that luxuries tend to become relatively more important than necessities. It also means that attention is constantly being shifted from products for which the demand is relatively inelastic to products for which the demand is relatively elastic (that is, expansible). There are exceptions to this. For example, housing, which is obviously a necessity, is a product for which demand is fairly elastic and might continue to be so until most persons lived in palaces, but, on the whole, the demand for necessities is less elastic than the demand for luxuries.

A rising standard of living also means an increase in savings (or accumulation of surplus) out of all proportion to the rise in incomes. It is a fairly general rule both for societies and for individuals that savings go up faster than incomes as the latter rise, if for no other reason than the fact that a person with an adequate supply of necessities will take time to make up his mind on which luxuries he will expend any increase in income.

Finally, a shift from primary to secondary production usually entails a very great increase in capital investment, while a shift from secondary to tertiary production may not result in any increase in capital investment proportionately as great. Leisure, amusements, music, philosophy, education, and personal services are not likely to require capital investments comparable to those required by the construction of railroads, steel factories, automotive plants, and electrical stations.

As a result of these factors, it may well arise that a society whose rising standards of living have brought it to the point where it is passing from emphasis on secondary to emphasis on tertiary production will be faced with the necessity of adjusting itself to a

situation which includes more emphasis on luxuries than on necessities, more attention to products of elastic demand than inelastic, and increased savings with decreasing demands for investment.

Industrialism

2. Industrialization is an obvious element in modern economic development. As used here, it has a very specific meaning, namely, the application of inanimate power to production. For long ages, production was made by using power from animate sources such as human bodies, slaves, or draft animals, with relatively little accomplished by power from such inanimate sources as wind or falling water. The so-called Industrial Revolution began when the energy from coal, released through a nonliving machine—the steam engine—became an important element in the productive process. It continued through improvements in the use of wind power and waterpower to the use of oil in internal-combustion engines and finally to power from atomic sources.

The essential aspect of industrialism has been the great rise in the use of energy per capita of population. No adequate figures are available for most European countries, but in the United States the energy used per capita was:

Year	Energy Per Capita	Index
1830	6 million BTU	1
1890	80 million BTU	13
1930	245 million BTU	40

As a result of this increase in the use of energy per capita, industrial output per man-hour rose significantly (in the United States 96 percent from 1899 to 1929). It was this increase in output per man-hour which permitted the rise in standards of living and the increases in investment associated with the process of industrialization.

The Industrial Revolution did not reach all parts of Europe, or even all parts of any single country, at the same moment. In general, it began in England late in the eighteenth century (about 1776) and spread slowly eastward and southward across Europe, reaching France after 1830, Germany after 1850, Italy and Russia after 1890. This eastward movement of industrialism had many significant results, among them the belief on the part of the newer countries that they were at a disadvantage in comparison with England because of the latter's head start. This was untrue, for, from a strictly temporal point of view, these newer countries had an advantage over England, since their newer industrial installations were less obsolescent and less hampered by vested interests. Whatever advantage England had arose from better natural resources, more plentiful supply of capital, and skilled labor.

Growth of Size of Enterprises

3. The growth of size of enterprise was a natural result of the process of industrialism. This process required very considerable outlays for fixed capital, especially in the activities most closely associated with the early stages of industrialism, such as railroads, iron foundries, and textile mills. Such great outlays required a new legal structure for enterprise. This was found in the corporation or limited-liability joint-stock company. In this company large capital installations could be constructed and run, with ownership divided into small fractions among a large number of persons.

This increase in size of units was apparent in all countries, but chiefly in the United States, Britain, and Germany. The statistics on this are incomplete and tricky to use, but, in general, they indicate that, while the number of corporations has been increasing, and the average size of all corporations has been falling, the absolute size of the largest corporations has been increasing rapidly in the twentieth century, and the share of total assets or of total output held h! the largest corporations has been rising. As a result, the output of certain products, notably chemicals, metals, artificial fibers, electrical equipment, and so on, has been dominated in most countries by a few great firms.

In the United States, where this process has been studied most carefully, it was found that from 1909 to 1930 the number of billion-dollar corporations rose from 1 to 15, and the share of all corporation assets held by the 200 largest rose from 32 percent to over 49 percent. By 1939 this figure reached 57 percent. This meant that the largest 200 corporations were growing faster than other corporations (5.4 percent a year compared to 2.0 percent a year) and faster than total national wealth. As a result, by 1930 these 200 largest corporations had 49.2 percent of all corporate assets (or $81 billion out of $165 billion); they had 38 percent of all business wealth (or $81 billion out of $212 billion); they held 22 percent of all wealth in the country (or $81 billion out of $367 billion). In fact in 1930, a single corporation (American Telephone and Telegraph) had greater assets than the total wealth in 21 states. No such figures are available for European countries, but there can be no doubt that similar growth was taking place in most of them during this period.

Dispersal of Ownership of Enterprises

4. Dispersal of ownership of enterprise was a natural result of the growth of size of enterprise, and was made possible by the corporate method of organization. As corporations increased in size, it became less and less possible for any individual or small group to own any important fractions of their stocks. [An individual or family can maintain control of a corporation by holding as little as 5-10 percent of the stock.] In most countries the number of security holders increased faster than the number of outstanding securities. In the United States the former increased in numbers seven times as fast as the latter from 1900 to 1928. This was a greater spread than in other countries, but elsewhere there was also a considerable spreading out of corporate ownership. This was exactly contrary to the prediction of Karl Marx that the owners of industry would get fewer and fewer as well as richer and richer.

Separation of Control from Ownership

5. The separation of ownership from control has already been mentioned. It was an inevitable counterpart of the advent of the corporate form of business organization; indeed, the corporate form was devised for this very purpose—that is, to mobilize the capital owned by many persons into a single enterprise controlled by a few. As we have seen, this inevitable counterpart was carried to a quite unexpected degree by the devices invented by financial capitalism.

Concentration of Control

6. The concentration of control was also inevitable in the long run, but here also was carried by special devices to an extraordinary degree. As a result, in highly industrialized countries, the economic systems were dominated by a handful of industrial complexes. The French economy was dominated by three powers (Rothschild, Mirabaud, and Schneider); the German economy was dominated by two (I. G. Farben and Vereinigte Stahl Werke); the United States was dominated by two (Morgan and Rockefeller). Other countries, like Italy or Britain, were dominated by somewhat larger numbers....

In the United States, Morgan ... [guided] the economic swing from financial to monopoly capitalism, and yielded quite gracefully to the rising power of du Pont. In Britain, likewise, the masters of financial capitalism yielded to the masters of chemical products and vegetable oils, once the inevitable writing on the wall had been traced out in a convincing fashion. But all these shifts of power within the individual economic systems indicate merely that individuals or groups are unable to maintain their positions in the complex flux of modern life, and do not indicate any decentralization of control. On the contrary, even as group succeeds group, the concentration of control becomes greater.

Decline of Competition

7. A decline in competition is a natural consequence of the concentration of control. This decline in competition refers, of course, only to price competition in the market, since this was the mechanism which made the economic system function in the nineteenth century. This decline is evident to all students of modern economics, and is one of the most widely discussed aspects of the modern economic system. It is caused not only by the activities of businessmen but also by the actions of labor unions, of governments, of private social welfare organizations, and even of the herd-like behavior of consumers themselves.

Increasing Disparity in the Distribution of Incomes

8. The increasing disparity in the distribution of income is the most controversial and least well-established characteristic of the system. The available statistical evidence is so inadequate in all European countries that the characteristic itself cannot be proved

conclusively. An extensive study of the subject, using the available materials for both Europe and the United States, with a careful analysis of the much better American materials, will permit the following tentative conclusions. Leaving aside all government action, it would appear that the disparity in the distribution of the national income has been getting wider.

In the United States, for example, according to the National Industrial Conference Board, the richest one-fifth of the population received 46.2 percent of the national income in 1910, 51.3 percent in 1929, and 48.5 percent in 1937. In the same three years, the share of the poorest one-fifth of the population fell from 8.3 percent to 5.4 percent to 3.6 percent. Thus the ratios between the portion obtained by the richest one-fifth and that obtained by the poorest one-fifth increased in these three years from 5.6 to 9.3 to 13.5. If, instead of one-fifths, we examine the ratios between the percentage obtained by the richest one-tenth and that obtained by the poorest one-tenth, we find that in 1910 the ratio was 10; in 1929 it was 21.7; and in 1937 it was 34.4. This means that the rich in the United States were getting richer relatively and probably absolutely while the poor were getting poorer both relatively and absolutely. This last is caused by the fact that the increase in the real national income in the period 1910-1937 was not great enough to compensate for the decrease in percentage going to the poor or for the increase in number of persons in that class.

As a result of such an increase in disparity in the distribution of national income, there will be a tendency for savings to rise and for consumers' purchasing power to decline relative to each other. This is because the savings of a community are largely made by the richer persons in it, and savings increase out of all proportion as incomes rise. On the other hand, the incomes of the poor class are devoted primarily to expenditures for consumption. Thus, if it is correct that there is an increasing disparity in the distribution of the national income of a country, there will be a tendency for savings to rise and consumer purchasing power to decline relative to each other. If this is so, there will be an increasing reluctance on the part of the controllers of savings to invest their savings in new capital equipment, since the existing decline of purchasing power will make it increasingly difficult to sell the products of the existing capital equipment and highly unlikely that the products of any new capital equipment could be sold more easily.

This situation, as we have described it, assumes that the government has not intervened in such a way as to change the distribution of the national income as determined by economic factors. If, however, the government does intervene to disturb this distribution, its actions will either increase the disparity in its distribution or will decrease it. If these actions increase it, the problem of the discrepancy to which we have referred between savings, on one hand, and the level of purchasing power and investment, on the other, will be made worse. If, on the other hand, the government adopts a program which seeks to reduce the disparity in the distribution of the national income, by, for example, adopting a program of taxation which reduces the savings of the rich while increasing the purchasing power of the poor, the same problem of insufficient investment will arise. Such a tax program as we have described would have to be based on a graduated income tax, and, because of the concentration of saving in the upper-

income brackets, would have to be carried to such a sharp degree of graduation that the taxes of the very rich would be rapidly approaching the level of confiscation. This would, as the conservatives say, "kill incentive." Of this there can be no doubt, for any person with an income already large enough to satisfy his consumers' wants will be very unlikely to possess any incentive to invest if each dollar of profit made from such investment is to have all but a few cents of its value taken by the government in the form of taxation.

In this way, the problem of increasing disparity in the distribution of national income leads to a single result (decline of investment relative to savings), whether the situation is left subject to purely economic factors or the government takes steps to decrease the disparity. The only difference is that, in the one ease, the decline in investment may be attributed to a leek of consumer purchasing power, while, in the other case, it may be attributed to a "killing of incentive" by government action. Thus, we see that the controversy which has raged in both Europe and America since 1932 between progressives and conservatives in regard to the causes of the lack of investment is an artificial one. The progressives, who insisted that the lack of investment was caused by lack of consumer purchasing power, w ere correct. But the conservatives, who insisted that the lack of investment was caused by a lack of confidence, were also correct. Each was looking at the opposite side of what is a single continuous cycle.

This cycle runs roughly as follows: (a) purchasing power creates demand for goods; (b) demand for goods creates confidence in the minds of investors; (c) confidence creates new investment; and (d) new investment creates purchasing power, which then creates demand, and so on. To cut this cycle at any point and to insist that the cycle begins at that point is to falsify the situation. In the 1930's the progressives concentrated attention on stage (a), while the conservatives concentrated attention on stage (c). The progressives, who sought to increase purchasing po\ver by some redistribution of the national income, undoubtedly did increase purchasing power under stage (a), but they lost purchasing power under stage (c) by reducing confidence of potential investors. This decrease of confidence was especially noticeable in countries (like France and the United States) which were still deeply involved in the stage of financial capitalism.

It would appear that the economic factors alone affected the distribution of incomes in the direction of increasing disparity. In no major country, however, were the economic factors alone allowed to determine the issue. In all countries government action noticeably influenced the distribution....

In Italy the economic factors had relatively free rein until after the creation of the corporative state in 1934. The effect of government action was to increase the normal economic tendency toward an increasing disparity in distribution of the national income. This tendency had been allowed to work from an early period until the end of the war in 1918. A drastic effort by Leftish influences in the period 1918-1922 resulted in government action which reversed this tendency. As a result, a counterrevolution brought Mussolini to power in October 1922. The new government suppressed those government actions which had hampered the normal economic tendency, and as a result the trend toward greater disparity in distribution of the national income was resumed. This trend

became more drastic after the creation of the dictatorship in 1925, after the stabilization of the lira in 1927, and after the creation of the corporative state in 1934.

In Germany the changes in distribution of the national income were similar to those in Italy. although complicated by the efforts to create a social-service state (an effort going back to Bismarck) and by the hyperinflation. In general, the trend toward increasing disparity in distribution of the national income continued, less rapidly than in Italy, until after 1918. The inflation, by wiping out unemployment for the lower class and by wiping out the savings of the middle class, created a complex situation in which the wealth of the richest class was increased while the poverty of the poorest class was reduced, and the general trend toward increased disparity in income was probably reduced. This reduction became great under the social-service state of 1924-1930, but was drastically reversed because of the great increase in poverty in the lower classes after 1929. After 1934 the adoption of an unorthodox financial policy and a policy of benefits to monopoly capitalism reinforced the normal trend toward increasing disparity in distribution of income. This was in accord with the desires of the Hitler government, but the full impact of this policy was not apparent on the distribution of incomes until the period of full employment after 1937.

Until 1938 Hitler's policy, although aimed at favoring the high-income classes, raised the standards of living of the lower-income levels even more drastically by shifting them from unemployment with incomes close to nothing into wage-earning positions in industry) so that the disparity in distribution of income was probably even reduced for a short-run period in 1934-1937. This was not unacceptable to the high-income classes, because it stopped the threat of revolution by the discontented masses and because it was obviously of long-run benefit to them. This long-run benefit began to appear when capacity employment of capital and labor was achieved in 1937. The continuance of the policy of rearmament after 1936 increased the incomes of the high-income groups while decreasing the incomes of the lower-income groups and thus served, from 1937 onward, to reinforce the normal economic tendency toward an increasing disparity int eh distribution of incomes. This, of course, is one of the essential features of a Fascist government, and is obvious not only in Germany since 1937, in Italy since 1927, but also in Spain since 1938.

In France and Britain, the trend toward increasing disparity in the distribution of incomes was reversed in recent decades, although in Britain before 1945 and in France before 1936 there was no conscious effort to achieve this result.

In France disparity increased until 1913, then decreased chiefly because of the increasing power of labor unions and actions of the government. The inflation and resulting devaluation badly injured the incomes of the possessing class, so that the disparity became less disperse; but the whole level of living standards was declining, savings were declining, and investment was decreasing more rapidly than either. This process became worse after the depression hit France about 1931 and even worse after the Popular Front adopted its welfare program in 1936. This decline of the general

economic level continued quite steadily except for a brief revival after 1938, but the disparity in the distribution of incomes very likely became greater in 1940-1942.

In Britain the disparity became greater, but at a slower rate (because of labor unions), until the First World War, and then almost stabilized, increasing only slightly, because of the severe efforts made in Britain to pay for much of the war's cost by taxation. The decrease in upper-level incomes by taxation, however, was more than overcome by the decrease in lower-level incomes from unemployment. This static condition of the disparity in distribution of the national income doubtless continued until after 1931. Since this last date the situation is confused. The revival of prosperity and the rapid development of new lines of activity combined with the peculiarities of the incidence of British taxation have likely reduced the disparity, but, until 1943, not by anything approaching the degree which one might expect from a first glance at the problem. Since 1943 and especially since 1946 the tax schedule and the government's social welfare program have drastically reduced the disparity in distribution of income and have also cut investment and even savings by private sources to a considerable degree.

It would seem that in the twentieth century the disparity in the distribution of national income, which had been increasing for generations, slowed down and reversed as a result of government activities. This turning point appeared in different countries at different dates, probably earliest in Denmark and France, later in Germany and Italy, latest in Britain and Spain. In France and Britain the tendency was reversed by the action of the government, but in a hesitant fashion which was not able, in any decisive way, to overcome the sag in private enterprise by any upswing in government enterprise. In Germany, Italy, and Spain the governments fell into the hands of the possessing classes, and the desires of the peoples of these countries for a more equitable distribution of incomes were frustrated. In all three types of conditions, there was a decline in real economic progress until after 1950.

Declining Rate of Expansion Leading to Crisis

9. A declining rate of economic expansion is the last important characteristic of the economic system of Europe in the present century up to 1950. This decline resulted almost inevitably from the other characteristics which we have already discussed. It varied from country to country, the countries of eastern Europe suffering less than those of western Europe on the whole, but chiefly because their previous rate of progress had been so much lower.

The causes of this decline are basically to be found in a relative increase in the power of the vested interests within the community to defend the status quo against the efforts of the progressive and enterprising members of the community to change it. This was revealed in the market (the central mechanism of the economic system) as a result of a relative increase in savings in respect to investment. Savings have continued or have increased for several reasons. In the first place, a tradition which placed a high social esteem on savings existed in western Europe from the Protestant Reformation until the

1930'S. In the second place, there had grown up established institutionalized savings organizations like insurance companies. In the third place, the rising standards of living increased savings even more rapidly. In the fourth place, the increasing disparity in the distribution of incomes increased savings. In the fifth place, the increase in size of enterprises and the separation of ownership from control acted to increase the amount of corporate savings (undistributed profits).

On the other hand, the inclination to invest did not rise so rapidly as savings, or even decreased. Here, again, the reasons are numerous. In the first place, the shift in advanced industrial countries from secondary to tertiary production reduces the demand for heavy capital investment. In the second place, declining rates of population increase, and geographic expansion may adversely affect the demand for investment. In the third place, the increasing disparity in the distribution of incomes, whether it is counteracted by government action or not, has a tendency to reduce the demand for investment capital. In the fourth place, the decrease in competition has served to reduce the amount of investment by making it possible for the controllers of existing capital to maintain its value by curtailing the investment of new capital which would make the existing capital less valuable. This last point may require additional explanation.

In the past, investment was not only capital-creating but also capital-destroying—that is, it made some existing capital worthless by making it obsolete. The creation by investment, for example, of shipyards for making iron-hull steam vessels not only created this new capital but at the same time destroyed the value of the existing yards equipped to make wooden-hull sailing ships. In the past, new investment was made in only one of two cases: (a) if an old investor believed that the new capital would yield sufficient profit to pay for itself and for the old investment now made obsolete, or (b) if the new investor was completely free of the old one, so that the latter could do nothing to prevent the destruction of his existing capital holdings by the new investor. Both of these two alternatives, in the twentieth century tended to become less likely (until 1950), the former by the decline in consumer purchasing power and the latter by the decrease in competition.

The way in which the relative decline of investment in respect to savings results in economic crisis is not difficult to see. In the modern economic community, the sum total of goods and services appearing in the market is at one and the same time the income of the community and the aggregate cost of producing the goods and services in question. The sums expended by the entrepreneur on wages, rents, salaries, raw materials, interest, lawyers' fees, and so on, represent costs to him and income to those who receive them. His own profits also enter the picture, since they are his income and the cost of persuading him to produce the wealth in question. The goods are offered for sale at a price which is equal to the sum of all costs (including profits). In the community as a whole, aggregate costs, aggregate incomes, and aggregate prices are the same, since they are merely opposite sides of the identical expenditures.

The purchasing power available in the community is equal to income minus savings. If there are any savings, the available purchasing power will be less than the

aggregate prices being asked for the products for sale and by the amount of the savings. Thus, all the goods and services produced cannot be sold as long as savings are held back. In order for all the goods to be sold, it is necessary for the savings to reappear in the market as purchasing power. The usual way in which this is done is by investment. When savings are invested, they are expended into the community and appear as purchasing power. Since the capital good made by the process of investment is not offered for sale to the community, the expenditures made by its creation appear completely as purchasing power. Thus, the disequilibrium between purchasing power and prices in which was created by the act of saving is restored completely by the act of investment, and all the goods can be sold at the prices asked. But whenever investment is less than savings, the available supply of purchasing power is inadequate by the same amount to buy the goods being offered. This margin by which purchasing power is inadequate because of an excess of savings over investment may be called the "deflationary gap." This '"deflationary gap" is the key to the twentieth century economic crisis and one of the three central cores of the whole tragedy of the century.

Chapter 37—The Results of Economic Depression

The deflationary gap arising from a failure of investment to reach the level of savings can he closed either by lowering the supply of goods to the level of the available purchasing power or by raising the supply of purchasing power to a level able to absorb the existing supply of goods, or by a combination of both. The first solution will give a stabilized economy on a low level of economic activity; the second will give a stabilized economy on a high level of economic activity. Left to itself, the economic system under modern conditions would adopt the former procedure. This would work roughly as follows: The existence of the deflationary gap (that is, available purchasing power less than aggregate prices of available goods and services) will result in falling prices, declining economic activity, and rising unemployment. All this will result in a fall in national income, and this in turn will result in an even more rapid decline in the volume of savings. This decline continues until the volume of savings reaches the level of investment, at which point the fall is arrested and the economy becomes stabilized at a low level.

As a matter of fact, this process did not work itself out in any industrial country during the great depression of 1929-1934, because the disparity in the distribution of the national income was so great that a considerable portion of the population would have been driven to zero incomes and absolute want before the savings of the richer segment of the population fell to the level of investment. Moreover, as the depression deepened, the level of investment declined even more rapidly than the level of savings. There can be little doubt that under such conditions the masses of the population would have been driven to revolution before the "automatic economic factors" were able to stabilize the economy, and the stabilization, if reached, would have been on a level so low that a considerable portion of the population would have been in absolute want. Because of this, in every industrial country, governments took steps to arrest the course of the depression before their citizens were driven to desperation.