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.

The methods used to deal with the depression and close the deflationary gap were of many different kinds, but all are reducible to two fundamental types: (a) those which destroy goods and (b) those which produce goods which do not enter the market.

The destruction of goods will close the deflationary gap by reducing the supply of unsold goods through lowering the supply of goods to the level of the supply of purchasing power. It is not generally realized that this method is one of the chief ways in which the gap is closed in a normal business cycle. In such a cycle, goods are destroyed hy the simple expedient of not producing the goods which the system is capable of producing. The failure to use the economic system at the 1929 level of output during the years 1930-1934 represented a loss of goods worth $100,000,000,000 in the United States, Britain, and Germany alone. This loss was equivalent to the destruction of such goods. Destruction of goods by failure to gather the harvest is a common phenomenon under modern conditions, especially in respect to fruits, berries, and vegetables. When a farmer leaves his crop of oranges, peaches, or strawberries unharvested because the selling price is too low to cover the expense of harvesting, he is destroying the goods. Outright destruction of goods already produced is not common, and occurred for the first time as a method of combating depression in the years 1930-1934. During this period, stores of coffee, sugar, and bananas were destroyed, corn was plowed under, and young livestock was slaughtered to reduce the supply on the market. This destruction of goods in warfare is another example of this method of overcoming deflationary conditions int he economic system.

The second method of filling the deflationary gap, namely, by producing goods which do not enter the market, accomplishes its purpose by providing purchasing power in the market, since the costs of production of such goods do enter the market as purchasing power, while the goods themselves do not drain funds from the system if they are not offered for sale. New investment was the usual way in which this was accomplished in the normal business cycle, but it is not the normal way of filling the gap under modern conditions of depression. We have already seen the growing reluctance to invest and the unlikely chance that the purchasing power necessary for prosperity will be provided by a constant stream of private investment. If this is so, the funds for producing goods which do not enter the market must be sought in a program of public spending.

Any program of public spending at once runs into the problems of inflation and public debt. These are the same two problems which were mentioned in an earlier chapter in connection with the efforts of governments to pay for the First World War. The methods of paying for a depression are exactly the same as the methods of paying for a war, except that the combination of methods used may be somewhat different because the goals are somewhat different. In financing a war, we should seek to achieve a method which will provide a maximum of output with a minimum of inflation and public debt. In dealing with a depression, since a chief aim is to close the deflationary gap, the goal will be to provide a maximum of output with a necessary degree of inflation and a minimum of public debt. Thus, the use of fiat money is more justifiable in financing a depression than in financing a war. [Fiat money without gold and silver backing should not be used to finance either.] Moreover, the selling of bonds to private persons in wartime might well be aimed at the lower-income groups in order to reduce consumption and release facilities for war production, while in a depression (where low consumption is the chief problem) such sales of bonds to finance public spending would have to be aimed at the savings of the upper-income groups.

These ideas on the role of government spending in combating depression have been formally organized into the "theory of the compensatory economy." This theory advocates that government spending and fiscal policies be organized so that they work exactly contrary to the business cycle, with lower taxes and larger spending in a deflationary period and higher taxes with reduced spending in a boom period, the fiscal deficits of the down cycle being counterbalanced in the national budget by the surpluses of the up cycle.

This compensatory economy has not been applied with much success in any European country except Sweden. In a democratic country, it would take the control of taxing and spending away from the elected representatives of the people and place this precious "power of the purse" at the control of the automatic processes of the business cycle as interpreted by bureaucratic (and unrepresentative) experts. Moreover, all these programs of deficit spending are in jeopardy in a country with a private banking system. In such a system, the creation of money (or credit) is usually reserved for the private banking institutions, and is deprecated as a government action. The argument that the creation of funds by the government is bad while creation of funds by the banks is salutary is ... [made] in a system based on traditional laissez faire and in which the usual avenues of communications (such as newspapers and radio) are under private, or even banker, control.

Public spending as a method of counteracting depression can vary very greatly in character, depending on the purposes of the spending. Spending for destruction of goods or for restriction of output, as under the early New Deal agricultural program, cannot be justified easily in a democratic country with freedom of communications, because it obviously results in a decline in national income and living standards. Spending for nonproductive monuments is ... hardly a long-run solution. Spending for investment in ... equipment (like the TVA) is ... a permanent departure from a system of private capitalism, and can be easily attacked in a country with a capitalistic ideology and a private banking system. Spending on armaments and national defense is the last method of fighting depression and is the one most readily and most widely adopted in the twentieth century.

A program of public expenditure on armaments is a method for filling the deflationary gap and overcoming depression because it adds purchasing power to the market without drawing it out again later (since the armaments, once produced, are not put up for sale). From an economic point of view, this method of combating depression is not much different from the method listed earlier under destruction of goods, for, in this case also, economic resources are diverted from constructive activities or idleness to production for destruction. The appeal of this method for coping with the problem of depression does not rest on economic grounds at all, for, on such grounds, there is no justification. Its appeal is rather to be found on other, especially political, grounds.

Among these grounds we may list the following: a rearmament program helps heavy industry directly and immediately. Heavy industry is the segment of the economy which suffers earliest and most drastically in a depression, which absorbs manpower most readily (thus reducing unemployment) and which is politically influential in most countries. Such a program is also easily justified to the public on grounds of national defense, especially if other countries are dealing with their economic crises by the same method of treatment.

The adoption of rearmament as a method of combating depression does not have to be conscious. The country which adopts it may honestly feel that it is adopting the policy for good reasons, that it is threatened by aggression, and that a program of rearmament is necessary for political protection. It is very rare for a country consciously to adopt a program of aggression, for, in most wars, both sides are convinced that their actions are defensive. It is almost equally rare for a country to adopt a policy of rearmament as a solution for depression. But, unconsciously, the danger from a neighbor and the advantages to be derived from rearming in the face of such a danger are always more convincing to a country whose economic system is functioning below capacity than it is to a country which is riding a boom. Moreover, if a country adopts rearmament because of fear of another country's arms, and these last are the result of efforts to fill a deflationary gap, it can also be said that the rearmament of the former has a basic economic cause.

As we have mentioned, Fascism is the adoption by the vested interests in a society of an authoritarian form of government in order to maintain their vested interests and prevent the reform of the society. In the twentieth century in Europe, the vested interests usually sought to prevent the reform of the economic system (a reform whose need was made evident by the long-drawn-out depression) by adopting an economic program whose chief element was the effort to fill the deflationary gap by rearmament.

Chapter 38—The Pluralist Economy and World Blocs

The economic disasters of two wars, a world depression, and the post-war fluctuations showed clearly by 1960 that a new economic organization of society was ... [being developed by the Money Power]. The laissez-faire competitive system ... [had been destroyed by the Money Power]. The system of monopoly capitalism had helped in this ... [destruction], and clearly showed that its efforts, in Fascist countries, [and other nations] to protect its profits and privileges by authoritarian government and ultimately by war were ... [successful] .... [although the Fascist countries such as Germany and Italy were not able to win the war they started]. Moreover, Communism, on the winning side of the war, nonetheless showed that it, like any authoritarian system, failed to produce innovations, flexibility, and freedom; it could make extensive industrial advances only by copying freer peoples, and could not raise its standards of living substantially because it could not combine lack of freedom and force in political life and in the utilization of