The Price Complex vs. Fundamental Economics

IGNORANCE of fundamental economics has brought this country to a crisis in the struggle for recovery. Desperate attempts have been made and are being made to repeal the economic laws by government fiat. To such an extent has this been taking place that one cannot be censured for imagining that in the very near future an effort will be made to regulate the weather in order to help business. Evidently there is no limit to the power and ingenuity of human beings. One of the "Brain Trust" recently said that the theory that the law of supply and demand maintained the economic balance without regulation had been disproved by the depression. If that is so, why had it not been disproved by former depressions? We have had several in this country and the same phenomena had been observed in all of them. But the "Brain Trust" prefers to look upon the present depression as something entirely different, as having no similarity to anything that happened in the past.

The Agriculture Adjustment Act and the National Recovery Act have been wobbling badly and Administration officials have been very much worried. Not realizing that their plans are based on false principles and so were doomed to fail, they are surprised and perturbed by the results. Of course, they are doing their best to compile the most favorable statistics in order to impress not only the people but themselves as well. They criticized the previous administration for painting rosy pictures, but they have fallen into the same habit themselves. A muzzle was placed on the Federal Reserve Board for fear it would issue another unfavorable report. Interpretation of recovery statistics has been restricted to one central agency under the direct control of the President's own Executive Council.

The results of the government's plans could have been foreseen. As a matter of fact, they were foreseen by those who had not lost sight of fundamental principles. There was no need to experiment in order to know the general results. A well-known British economist and statesman, in an analysis of the recovery programme, wrote, "It (meaning the United States government) is not under the delusion that, in the intricate complexity of the modern industrial system, with a variety of economic forces interacting and pulling this way and that, it is possible to foresee what the precise outcome will be of each particular measure or even of the policy as a whole." This, of course is absurd. A proper knowledge of economic laws will permit one to predict the general result and frequently the precise result of economic measures.

The Administration officials have been suffering from such a terrible price complex that it has distorted their entire reasoning. By hook or crook, they mean to raise prices. They have a regular bag full of tricks. If one trick does not succeed, it is an easy matter to dive into the bag and pull out another. While prices have risen considerably since March of this year, they have not reached the 1926 level—the level that will mean Utopia according to the Administration. For the farmers, this would mean an average rise from the March level of 130 per cent. Such a rise could not take place in a year under the most favorable circumstances. It did not happen during the war when other countries were forcing the farmers to the utmost to keep up with their demands. It could only take place through outright currency inflation.

But why should we go back to the 1926 level? All values have been lowered since that time and producers can afford to sell at lower prices today. Wages are lower, the cost of raw materials is lower and overhead expenses are lower. Farm prices of course fell lower than industrial prices. The reason for that is that industry curtailed production when prices fell, but the farmers increased production. Farm prices increased from March to July in a greater ratio than the prices of other commodities, but since July the situation was reversed. Nevertheless, the farmers' condition has improved but, according to the inflationists, it is not good enough.

The majority of the farmers are not complaining about low prices. Only those who are burdened with mortgages are suffering, because their incomes are not large enough to permit them to pay their taxes, interest and amortization. Those people who are obsessed with the price complex, believe that if prices rose to the 1926 level, debtors would be able to pay their debts. They assume that most of the debts were contracted in 1926. Before recovery can set in, debts, of course, must be liquidated. These debts were assumed largely in expectation of greater wealth-production. It is not necessary that these debts be liquidated in full before recovery can set in, but sufficient liquidation must take place in order to bring them in line with the productive power of industry or, in other words, in line with income. However, the process of liquidation has been steadily taking place through foreclosures, bankruptcies and compromise settlements. That these debts are nearing the proper level has been evidenced by signs of recovery which were first noticed at the end of May.

A great deal of the agitation for higher prices has been for the sake of the farmers whose farms are heavily mortgaged. These mortgages are being liquidated through foreclosure proceedings and eventually these farmers, while they will have been reduced to tenancy, will be in a position to produce, unhampered by heavy charges on their incomes. However, the purpose of the drive to raise prices is to enable the farmers to pay off their debts so they will not lose their farms. At first thought, this would seem to be prompted by a noble sentiment, but it is nothing of the sort. Why should these farmers be helped to hold on to farms that they never really owned? After they are foreclosed, they can operate as tenants at low rents and their condition will be much better than before. The reason why they are so keen about holding on to these farms is because they expect to make a profit on them some day—not as farmers but as speculators. The motive behind the drive for higher prices then is not the desire to help legitimate farmers but the desire to help speculators at the expense of everybody else.

It is futile to prevent the trend toward tenancy in this country among the farmers by superficial measures. At the end of the last century, one-third of the farmers were tenants. Today, more than half are tenants. Farm lands are being concentrated more and more in the hands of a few people. If farmers or those who wish to help them were sincere in their desire that they should own their own farms as legitimate producers, they would demand removal of the fundamental cause of increasing tenancy—namely, land speculation that inflates the price of land and causes mortgages to pile up. Inflation of the currency by an outright issue of paper money would be disastrous to almost everyone, including speculators. Only a few lucky speculators would be able to benefit from it. The creditors as individuals probably outnumber the debtors as individuals. If prices of farm products were doubled, the prices of industrial products would also be doubled. There is no certainty that the prices of farm products would rise higher than industrial prices and that farmers would be able to pay off their debts. It is not higher prices that would pay off debts but higher incomes, and higher prices would not necessarily mean higher incomes. Inflation would lead to an orgy of speculation and even if some of the old debts were paid, new debts would be contracted. People would be encouraged to go into debt. Those living on wages, salaries and fixed incomes would be driven to the point of starvation. Incomes would not rise in the same proportion as prices, demand would fall off, production would be checked, bankruptcies would result, banks would fail and we would be plunged in to a worse depression. Then we would have to start all over again.

So long as farmers remain subjective in their demand for equality, they will not succeed. They must eventually realize that their conditions cannot be improved by penalizing all other groups of producers through price-fixing, process taxes, government purchasing of commodities and currency depreciation. The fundamental cause of their troubles is not peculiar to their cause but is at the root of all economic troubles. They should ally themselves with other producers in a common cause. Until they do this, their struggle for equality will be futile because it is based on stupidity and selfishness.

The farmers are not the only debtors. Farm mortgages in May were estimated to be only about seven per cent of the total amount of private and public debts which at that time were about $134,000,000,000. The total amount of farm and urban mortgages were about 29 per cent of the total. The balance consists of debts owed by life insurance companies, real estate companies, investment trusts and finance companies, public utilities, railroads, industrial concerns, states, municipalities and the federal government. The greater part of these debts were contracted because of inflated land values—values that were fictitious and which were dependent on greater wealth-production. Such production could not have taken place for many more years. It depended on a great increase in population and a great increase in the invention and use of new machinery. The average business man's attention is directed toward land only when mortgages are involved or when funds are invested directly in land. When he invests in corporate securities, he does not realize that in most cases he is investing largely in land. The business analyst who takes the view that too much money was invested in fixed assets, considers land as just an asset and overlooks the fact that in the case of railroads, pipe lines, public utilities and many large industrial companies, land is the largest single asset. He does not appear to realize that public franchises, for instance, are land not only in the economic sense but in the legal sense. This type of analyst points out—and it is true—that as a business increases in size, the tendency to invest more and more in fixed assets, such as real estate and equipment, becomes greater. The interest charges on mortgages, bonds and long-term notes issued to finance this investment, and the depreciation charges on these assets finally eat into the net income when the expected increase in business does not materialize and receiverships and bankruptcies result.

The point that is involved, however, is this: While assets, such as buildings, equipment and fixtures depreciate in value from wear and tear and obsolescence, land rises in value during a period of increasing business activity. Therefore, increase in funded debts is limited by this tendency toward depreciation of assets like buildings, etc., but on the other hand, the tendency of land to rise in value encourages the building up of the funded debt. If we keep in mind the distinction between land and other tangible assets—these other assets being the product of labor and capital—we shall be able to see clearly the principal cause of the huge debt that has been burdening industry.

No one can do without land. In the economic sense, it consists of farm lands, timber lands, oil lands, coal and mineral deposits, rights of way, building sites and business locations. All producers depend on it, if only for standing room. Therefore, there is a constant demand for it and during a period of rising industrial activity, this demand increases because more land is needed. As the price of it rises, industry goes deeper and deeper into debt. This price cannot be brought down by producing more land as in the case of commodities. Its supply is limited and so its price continues to rise. Those who sell land will not let it go at its natural value but anticipate its future value. Those who issue bonds based on land assets, like the railroads and public utilities, also anticipate this future value. For a while, industry can absorb this increasing burden but finally it eats into the returns to labor and capital. Labor and capital then cannot meet the charges on the mounting debt and at the same time exist. It is at this point that production is checked and the demand for land falls off, causing its value to drop.

As this debt is based largely on fictitious values, it must be liquidated by the wiping out of these values. The quicker this liquidation takes place, the nearer we come to recovery. Industry needs cheap land. All the artificial attempts that have been made to prevent liquidation or to slow it up have retarded rather than aided recovery. The Home Loan Corporation activities and the refinancing of farm mortgages, ineffectual as they may be, and the Reconstruction Finance Corporation have contributed in the attempt to retard or prevent liquidation. However, a great many people in this country want these values maintained so as to protect their equities or investments based on such values. Like a drowning man who grasps at a straw, they refuse to face realities. They refused to recognize the fact that these values have disappeared and so believe that if prices are raised to the 1926 level, these values can be saved. But as I said before, it is not higher prices that will pay debts but higher incomes. If all prices were artificially raised, incomes would not be increased except in a few individual cases. A large supply of paper money thrown into the market by the government would not increase production and employment as the inflationists claim. There would be no gain in the general purchasing power of the community, for the existing currency and bank deposits would depreciate in value. The community would actually be poorer because the additional money would not represent a corresponding increase in real tangible wealth but a claim on wealth. It would have the same effect as a tax on the community. In the last analysis, commodities are exchanged for commodities but in this case commodities would be exchanged for something that did not represent commodities. If the prices of some commodities were artificially raised, as in the case of farm products, the producers of those commodities would receive higher incomes only temporarily because they would have been secured at the expense of the community. Prices would eventually fall again. Prices can only rise as a result of increased demand. It is low prices that increase demand, not higher prices. Individual producers should endeavor to keep prices as low as possible until the demand increases thru the increased ability of people to produce, or in other words, through increased employment, and then prices will rise naturally.

The drive by the Administration for higher prices has produced some strange inconsistencies. When prices rose under the NRA programme, for instance, a warning issued from Washington that they should not rise too high. This is difficult to reconcile with the effort to raise prices to the 1926 level by buying gold here and abroad at steadily increasing prices. The President's gold policy has caused a great deal of confusion and uncertainty. Business men have been timid about making commitments or have planned their operations according to erroneous ideas of what the results would be. A great deal of this confusion has been due to ignorance of fundamental principles. While I do not consider the money question as important as some people make it out to be, currency tinkering retards business and I think it might be wise to clear up some of the false impressions regarding it. It is these false impressions that cause the money problem to be overemphasized.

The popular belief is that if the value of gold is increased, the dollar depreciates in value and prices rise. Thus, some business men have been inclined to hold on to their stocks of merchandise believing that in doing so they were making a good investment. This belief is based on the idea that our paper currency in some mysterious fashion derives its value from the gold reserves that have been available for its redemption. But value is not a fluid that can be absorbed by material objects. Since we left the gold standard, our currency has not been redeemable in gold but yet our paper currency still has value. The value of our paper currency is its purchasing power. Its value in terms of gold has no bearing on its value in terms of other commodities. An increase in the supply of currency in circulation in relation to the supply of commodities in the market would raise prices. However, comparatively little gold has been bought and therefore the increase in the number of dollars in circulation has been too trivial to affect prices. While the value of the gold reserves in the banks has increased and has put the banks in a position to issue more currency and credit, this can only be done in response to the legitimate demands of industry. Industry, however, will not avail itself of this privilege until business improves. Prices, therefore, will not rise except very slightly and then only temporarily due to psychological reasons.

While the dollar has not depreciated in value in terms of commodities inside the country, it has depreciated on foreign exchanges because of its depreciated value in relation to the value of gold. Gold is not used in domestic trade to any extent, but it is used to settle foreign trade balances. When the dollar depreciates in terms of gold, it also depreciates in terms of other currencies, because gold is the standard by which the value of these other currencies is measured. The claim is made that world prices will rise in terms of the dollar and the result will be to raise prices in this country. This is not true. Prices could only rise if the demand for these world commodities exceeded the supply, and there is no indication of that at the present time. It is also claimed that we would gain an advantage in foreign trade. The advantage we would gain would be only temporary. Exports would tend to increase, but, on the other hand, imports would tend to decline. As exports are paid for with imports, our advantage would not last very long. Furthermore, it is not at all certain that we would gain even a temporary advantage except in raw products. Other countries could buy our raw goods cheaper than before and could sell finished products in other markets cheaper than we could. Failure to recognize these facts led a British economist, considered by many people to be the greatest in the world, to predict that when Great Britain went off the gold standard in September, 1931, prices inside that country would rise and she would gain an advantage over other countries in export trade. Experienced proved this prediction wrong and he later admitted his error. This error would never have been made if he had not lost sight of fundamental economic principles in his intense concentration on a mere medium of exchange. Facts are proving more and more every day that what controls prices is not the supply and demand of money but the supply and demand of commodities. One famous individual, who is more of an orator than an economist, recently demanded to know how business could improve unless the supply of money was increased. Evidently he believes this country of ours was built up with money.

While the gold policy is not as dangerous as most of its critics have claimed, it is futile as a means of raising prices. These critics say that it will destroy government credit and compel the government to issue greenbacks in order to finance its various recovery undertakings. But why should investors lose confidence in federal bonds? They would lose confidence in federal bonds if they thought that the currency would so depreciate in value that the income from these bonds would be smaller in purchasing power and that their market value would fall as a result. If the dollar depreciated, people would be more inclined to speculate than to invest. Believing that it would was the principal cause—it was purely psychological—of the recent drop in the value of federal bonds. Most of the false ideas about money could be avoided if people had a proper conception of value. When they realize—and they eventually will—that prices of commodities will not rise as a result of dollar manipulation, the federal bond market will be strengthened. England's experience bears this out. The government then will not be compelled to issue fiat money. If greenbacks are issued, it will be done deliberately because of the insane desire to raise prices to the 1926 level. Then government credit would be destroyed.

The depression was not due primarily to monetary causes and so no monetary policy of itself will promote recovery. Artificially raising prices will not bring about recovery. Only by increasing the natural opportunities for employment can purchasing power increase and business improve. However, arbitrarily raising wages, as was done under the NRA, does not increase the general purchasing power. Money wages have risen but real wages have not. The new liberal economics that is being taught embraces the theory that wealth must be decentralized for the general welfare. Too much wealth is held as capital, it is claimed, so that labor cannot buy back its own products. Capital is considered as something that is sterile. This idea ignores the dynamics of capital production. Capital is active and is constantly going through a process of transformation. Funds used for capital are part of the country's purchasing power.

Raising wages before the productive power of labor and capital increases, only raises the cost of production, so that there is no gain in purchasing power. High wages are the result of low cost of production and low wages are the result of high cost of production. Establishing minimum wages, shortening the hours of labor and restricting the use of machinery, increase the cost of production, curtail production and tend to lower wages in the aggregate. This tendency can be counteracted only by an increase in the productive power of labor that will make up for the raising of wages and the shortening of hours. Such increase in productive power depends of course on the free use of machinery. A natural rise in wages due to the increased demand for labor would not increase the cost of production because such a rise would proceed from greater productiveness with the same amount of labor and capital in the same number of hours. The amount of wages paid per unit would be less, but the total amount of wages paid would be more.

The idea that concentrated wealth should be distributed among the masses in order to increase the general purchasing power is behind the public works programme. It is based on the false theory that distributing the same amount of money among more people increases the demand for commodities. Public relief projects, while they help the individuals employed on them, must be paid for by industry. Thus, the increase in employment that results is secured at the expense of those who are now employed. There would be no gain in the total demand for commodities and of course prices would not rise. These projects are financed by bond issues. These bonds are bought with funds that are taken from industry and that go back into industry when construction of these various projects get under way through the purchase of supplies and materials and the payment of wages. Then in order to pay the interest and to retire these bonds, industry will be taxed. Industry is really lending money for the purchase of its own products and then paying itself back through the medium of taxes. Relief projects are a polite method of placing the unemployed on a dole.

A great many of these projects are being undertaken by the local governments. Grants and loans are made to them by the federal government. The indebtedness of these local governments is being increased as a result. Thousands of municipalities are almost insolvent and it does not seem very wise to add to their debts which are said to amount to about $18,500,000,000. Furthermore, new issues would tend to depress still further the market value of municipal bonds.

Some of these public undertakings are self-liquidating. While they will have to be financed by bond issues, this will not necessarily mean additional taxes. However, for the present, it will entail the transfer of funds from industry. If the banks absorb the bonds, their position will be less liquid and this will result in restriction of credit to industry. In order to make these projects self-liquidating and self-supporting, tolls will have to be levied on industry. This will result in increasing the cost of production of commodities or reducing profits. While the purchasing power of those who are given jobs on these projects would be increased, the purchasing power of everybody else would be curtailed and there would be no general gain—if anything, there would be a loss.

Although some of these public works, both self-liquidating and non-liquidating, would aid in wealth production by increasing the productive power of labor and capital, the benefits resulting from this increase would be absorbed by the increase in the value of land, not only adjoining these projects but all over the country. A rise in land values naturally follows renewed industrial activity and it takes some time before it overtakes the rise in wages and interest on capital. However, in the case of public works, the increase in land values would be anticipated. Therefore, the rise in land values would precede and not follow renewed activity. There is a strong possibility then that industry would be strangled before it could get started. The only gainers would be land speculators. Producers would be hampered because they would have to pay higher prices and rent for land than they do now. Not only that, producers would be compelled to pay double tribute for the same thing. They would have to pay higher prices and rents for land made more valuable by these relief projects and on top of that would have to pay tolls for the various services rendered by them. Many of them would be forced to stop producing, resulting in increased unemployment and lower wages, or would be shunted off on to inferior land where they could barely make a living. The situation would be further aggravated by some speculators holding land out of use entirely, waiting for a greater rise in its value—land that is required for production. More unemployment would result, for unemployment is only the inability of labor to apply itself to land, the source of all wealth. Most people are engaged in the extractive industries, and the rest, who need land for business sites, are engaged in modifying and shaping natural products to make them suitable for the satisfaction of human desires or in rendering services of various kinds to those who do the actual producing of wealth. The Secretary of the Interior recognizes the obstacle to production that inflated land values present because he warned speculators not to demand too high prices for the land that is needed by the Public Works Administration. If it is true in the case of relief projects, it must be true in the case of all production. Futile as his warning is, it is at least significant of the fact that the Administration has some glimmering of the part that land plays in our economic life.

It must also be pointed out that not only the federal government but the municipalities would be forced to purchase land at inflated prices. According to a report issued recently by Dun & Bradstreet, Inc., land speculation was the primary cause of the financial embarrassment of most cities. A rise in land values of course would temporarily benefit life insurance companies, savings banks and building loan associations; but as long as production was impeded, there would be no general prosperity.

When we consider all of these facts, is it any wonder that public construction for relief purposes failed in both Germany and Great Britain to bring back prosperity? We cannot borrow ourselves out of a depression. Recovery can only proceed from liquidation of debts, not from the piling up of debts.

Most business men have been puzzled by the postponement of recovery because they did not know the fundamental cause of the depression. Consequently, they looked to the government for some solution, believing, rather foolishly, that it should be more intelligent than they were. If the Administration has adopted measures that do not meet entirely with their approval, the responsibility lies not with the Administration but with these business men who had refused to think seriously about social and economic problems.

Recovery, of course, will take place eventually whether we do anything about it or not, through the gradual liquidation of debts, making it easier for men to produce. It can be speeded up, however, by lightening the burden of taxation on industry as much as possible and increasing the opportunities for the employment of labor and capital by giving them greater freedom of access to natural agents. As we regard the situation of today, we should do so with the future in mind. When this country finally emerges from the depression, most people will forget what really caused it—if they ever knew. But this they should keep in mind: As recovery takes place, the foundation is being laid for another crisis. Therefore, in considering remedies for the present situation, they should bend their efforts towards removing the fundamental weakness in our economic system which is the principal reason for our huge, internal debt—namely, land speculation.

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THE Society for Prevention of Cruelty to Children is neglecting its job when it allows foolish parents to name helpless babies "Nira" after the National Industrial Recovery Act. When these infants become old enough to realize what it is all about the true character of that measure will be generally known and the poor kids may be mercilessly taunted for a name that stands for "Nutty Idiotic Roosevelt Accomplishment." It is bad enough that babies are doomed to be born into a world where they are robbed of their right to the earth. Why should they bear the additional burden of being branded with the name of a fake effort to remedy that crime?