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EDITED BY

JOHN A. KROUT

THE ACADEMY OF POLITICAL SCIENCE
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CONTENTS

PAGE

No. 4. The Effect of the War on America's Idle Men and Idle Money

I: THE RECOVERY PROBLEM UNDER WAR INFLUENCES

II: WILL WAR REMOVE THE OBSTACLES TO PRIVATE INVESTMENT AND EMPLOYMENT?

III: THE WAR'S EFFECT UPON AMERICA'S ECONOMY

PROCEEDINGS

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ESSENTIALS FOR SUSTAINED RECOVERY

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
MARCH 25, 1938

EDITED BY

JOHN A. KROUT

THE ACADEMY OF POLITICAL SCIENCE

COLUMBIA UNIVERSITY

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PREFACE

SINCE the autumn of 1929 the relation of government and business in any general program for recovery has been a topic of immediate concern to the American people. Yet the persistent debate on this highly controversial subject is seldom enlightening. In the vigorous presentation of conflicting opinions, too often emotion is mistaken for reason, and that which is superficial obscures the fundamentals. As the current business recession gives evidence of developing into a serious economic crisis, it seems prudent to emphasize, dispassionately and realistically, those factors which constitute the essentials for sustained recovery. The Academy of Political Science publishes this volume of its Proceedings, which contains the papers presented to the Semi-Annual Meeting (Fifty-eighth Year) at the Hotel Astor, New York City, on Friday, March 25, 1938, in the hope that it may stimulate further discussion and prove helpful to those who are responsible for the determination of public policies in state and nation.

To the speakers, to the presiding officers and to the Committee on Program and Arrangements the Academy is deeply indebted. The members of the Committee were: Wesley C. Mitchell (Chairman), Miss Ethel Warner (Director), W. Randolph Burgess, Lewis W. Douglas, Leon Fraser, Raymond V. Ingersoll, Thomas W. Lamont, Roswell C. McCrea, George O. May, Shepard Morgan, William L. Ransom, Gerard Swope, Leo Wolman and Owen D. Young.

CONTENTS

PART I

IMPACT OF REFORM ON RECOVERY

INTRODUCTION *

LEO WOLMAN, *Presiding*
Professor of Economics, Columbia University

THIS is the semi-annual meeting of the Academy of Political Science, and once more the Academy meets to consider business depression and the means of producing more or less lasting recovery. After four years of improvement, the curves of economic activity have again turned down, and government, business, farmers and wage-earners are concerned with the familiar problems of depression—unemployment, falling prices, reduced margins of profit, and the prospect of diminishing revenues and an increasing public debt.

With respect to the causes and cures of this disease that now plagues us in this country, there is wide and sharp difference of opinion. On one point alone can there be said to be an approach to agreement, and that is that cycles of prosperity and depression do not faithfully repeat themselves. In each there will be found new factors or old ones, compounded in new proportions, that tend to complicate analysis and make difficult the choice of alternative policies.

During these latest years of American business history, programs of economic and social reform have come to be regarded as powerful, if not determining, factors in the course of business. Policies aimed at redistributing wealth and income, regularizing employment, controlling industries charged with a plain public interest, and providing adequate care for the unemployed have become the principal preoccupations of our government.

* Opening remarks at the First Session of the Semi-Annual Meeting.

In the electric light and railroad industries, programs of control and reform are conceded to have a direct bearing on the attitude of private enterprise and the prospects for improving business. The private construction industry, in many previous periods of good business the foundation of expanding activity, has failed to respond sufficiently to the assistance of government, and is now in the throes of a new and substantial decline. Beginning with the N.R.A. in 1933, many novel factors have come to play a considerable rôle in our labor situation.

What public policy is and has been in these diverse situations, and how it may affect the state of business, is the subject of this morning's discussion.

We regret to announce that Mr. Arthur E. Morgan, who was to read the first paper, was unable to keep his engagement. Until the last moment he had hoped to appear and discuss public policy and the outlook for the utility industry. We spoke to him at Yellow Springs on Wednesday. He sent his deep regrets to the members of the Academy and promised to speak before one of our meetings at the very earliest opportunity.

The Academy is fortunate this morning to have for consideration of this difficult subject a group of scholars eminently qualified by practical experience as well as by long scientific training.

The first speaker will be Professor Isaiah L. Sharfman, of the University of Michigan, one of our foremost students of the railroad problem, adviser to many government agencies, and author of a notable treatise on the Interstate Commerce Commission, the oldest and most important of the Federal administrative boards. Professor Sharfman!

THE ELEMENTS OF A RAILROAD PROGRAM

I. L. SHARFMAN
Professor of Economics, University of Michigan

IT is everywhere recognized today that the railroad industry is in the midst of a grave crisis. Since the seriousness of the situation has come to be a matter of common knowledge, it is hardly necessary, in the few minutes here available, to set forth in any detail the factual circumstances responsible for the widespread apprehension. Because of the large and growing number of lines in receivership and reorganization, with the specter of bankruptcies rendered the more ominous by the increasingly discouraging results of current operations, both private interests and public authorities are deeply concerned over the railroad outlook, and a great variety of expedients are in process of exploration as possible avenues of relief.

Despite the rather liberal public credit extended to the railroads during the depression years, almost a hundred carriers, operating not far from one third of the entire railroad mileage of the country, are in the hands of receivers or trustees; and a large number of additional carriers, probably embracing another third of the railroad mileage and including some companies traditionally grouped among the strong and prosperous roads, are encountering serious difficulty in realizing current earnings sufficient to meet their fixed obligations. The pressure of these circumstances was brought to a head by the present phase of the economic depression. While the substantial recovery in the general industrial sphere which culminated in the summer of 1937 was paralleled in reasonably satisfactory measure among the railroads, it was followed, under the impact of the so-called business recession, by a precipitate and severe decline in railroad tonnage which does not appear, as yet, to have spent itself; and the critical financial situation which sprang from this sharp shrinkage in the volume of traffic was greatly accentuated by large increases in railroad operating costs, as a result of advances in wages, in taxes, and in prices of materials and supplies. Under these conditions the private credit of the railroads has been virtually destroyed, and the carriers, taken as a whole, find it difficult to provide for full maintenance of their properties, and are without practicable means of attracting the capital necessary to effect improvements in service or economies in operation.

The principal objective of the railroads is to widen the spread between their revenues and expenses, so that they may achieve a more adequate net railway operating income. To this end they have sought authority from time to time, with measurable success, to institute advances in rates, and they are now in process of negotiation with representatives of their organized employees for wage reductions. But while the guiding objective is a necessary and desirable one—it being universally acknowledged that railroad earnings are far from sufficient to maintain the industry in the condition of financial health essential to the provision of adequate transportation service—it is difficult to escape the conclusion that these expedients are calculated, at best, to operate only as palliatives. It is very generally appreciated that such means alone, however favorable their immediate outcome may appear to be, cannot be expected to meet the grave and pressing problem of the railroads in any durable or far-reaching way. The Interstate Commerce Commission, viewing the railroad situation in all its numerous ramifications, has rendered pronouncements to this effect on many occasions; the thorough inquiries of the Federal Coördinator of Transportation, conducted with high competence during three crucial years of the depression, led to like conclusions; and similar views have not only been expressed frequently by private interests directly or indirectly related to the railroad industry, but are clearly reflected in the disclosures, not yet reduced to formal findings and recommendations, of the Senate Committee investigating railroad finance, as well as in the conferences of governmental and private interests recently held under the leadership of the President of the United States.

The proposals for meeting the difficulties of the railroads which have emerged in the course of all these discussions have been many and varied. Even the method of public ownership and operation has received some attention; but most of the expedients under consideration hold in view modifications or

extensions of the existing regulatory structure. It is neither necessary for our purposes nor possible in the limited time available to catalogue and describe and appraise all the proposals, or to consider even the more important of them in any but very general terms. They embrace, for example, such relatively minor demands of questionable validity as the elimination of the long-and-short-haul prohibition, in the interest of according the railroads a greater degree of flexibility in meeting the pressure of other forms of transportation, and the restoration to the rule of rate-making of the "fair return on fair value" formula, in the interest of imposing a more definite responsibility upon the Commission in the matter of railroad returns. Of greater importance and more soundly conceived are those proposals which place emphasis upon the need of subjecting the entire transportation system, including water carriers and air carriers, to the regulatory powers of the Commission, along the comprehensive lines now applicable to transportation by rail and highway, so that the railroads may be relieved of the artificial handicaps which are produced by the favored public treatment of some of their competitors. Principally and most significantly, however, they are concerned with effecting such financial and operating reorganization of the railroad net as is calculated to accommodate railroad capital structures to existing and reasonably prospective transportation conditions, and to eliminate the large wastes incident to multiple corporate ownership under the traditional competitive set-up and individualistic functioning of the railroad industry.

In searching for so-called "solutions" of the railroad problem in its contemporary phase, it is of the utmost importance that the realities of the situation, however unpalatable, be faced with candor; and such a facing of realties not only discloses the futility of relying upon panaceas—upon policies of automatic miracle-working potentialities—but virtually removes the possibility of according quick and sure relief to the railroads, under their existing financial and operating organizations, except through the uneconomic instrumentality of public subsidies. Such convictions with respect to the immediate situation spring from the patent circumstance that external factors—expressions of the general economic situation and of the transportation system as a whole—are the predominant factors in the present plight of the railroads. More concretely, these external factors are: first, the drastic curtailment of economic activity as a result of the depression; and second, the growing impact of the competition of alternative transportation agencies.

The services of the railroads, particularly in their important freight-carrying capacity, are anxiliary to the entire complex of commercial, industrial and agricultural activity which constitutes the economic life of the nation. When that economic life becomes disrupted, as it has been very seriously disrupted throughout the nineteen-thirties, it is inevitable that transportation enterprise, embracing huge fixed capital commitments, should find it difficult or even impossible to pay its way. Transportation facilities constitute an integral part of our modern economic mechanism, and the fate of business as a whole is bound also to be the fate of transportation. Throughout the past seven lean and distressing years, the financial showing of the railroads has followed for the most part the ups and downs of general economic activity, and the immediate critical situation is likewise the result principally of sharp curtailment of traffic, induced primarily by the severity of the business recession. The basic need is for a very substantial increase in the demand for transportation service, so that a reasonably adequate utilization of railroad plant and equipment may be made possible; and this need can be successfully met, especially in view of the pressure of other forms of transportation, only by a full and sustained economic recovery.

For another external factor, within the transportation industry itself, has magnified the railroad embarrassments of recent years. The impact of the depression upon the railroads has been the more severe and debilitating because of the rapid development of alternative transportation agencies and services, the intense competition of which has resulted in vast diversions of even the greatly reduced traffic available under the depression economy. These newer agencies and services—by highway, water, air and pipeline—are permanent constituents of the prevailing system of transportation, and their expanding activities are bound to restrict the profitableness of railroad enterprise. It is important, of course, that the struggle within the transportation industry be maintained on an equitable basis,

so that victory in any given situation may accrue to economic superiority, in level of costs or quality of service, rather than to artificial advantage; but it is equally important, and soundly established policy, that the users of the instrumentalities of carriage, as well as the community at large, be not deprived of the fruits of progress in transportation, in mere support of the vested interests of the railroads and their owners. There can be little question, in these circumstances, that the newer transport agencies, though now sharing the distress of the railroads, are here to stay. They have enlarged the transportation system enormously, and they have rendered it readily expansible, particularly through the channels of motor-carrier service. In the large, then, the underlying difficulty of the contemporary scene is to be found in a very substantial surplus of transportation capacity. Even with a normal flow of traffic the railroads can scarcely escape the adverse effects of these transportation conditions; the conjunction of the business depression and the new competition, unmitigated by any drastic change in the financial and operating organization of the railroads, has produced the pressing elements of the recent crisis. It is this general economic and transportation environment which renders immediate relief to the railroads, on any sound basis, virtually impossible of accomplishment.

There appears to be no valid basis for further resort, in the present crisis, to the expedient of rate advances. Since transportation charges find their way into the producing or distributing costs of the entire range of economic enterprise, additional increases in these charges would tend to hamper the very recovery movement upon which the salvation of the railroads chiefly depends; and since the railroads are faced by a sensitive and vigorous competition from other forms of transportation, higher rates might well accelerate the very diversion of traffic which has constituted an important contributory cause of their difficulties. While it is too much to expect that the intricate rate structure of the railroads will at any given time be entirely free from maladjustments, there is no evidence whatever, aside from the financial needs of the carriers, that the general level of railroad rates is unreasonably low. A careful examination of the rate-level determinations of the Interstate Commerce Commission during the depression years discloses, on the whole, an attitude of liberality rather than of restriction, grounded in a deep concern over the low financial status of the roads. It is significant that throughout these years, despite the cataclysmic fall of commodity prices and the universal business distress at the depth of the depression, there has been no general reduction of railroad rates. On the contrary, substantial advances have been authorized on a number of occasions: in 1931 and 1935, in the form of emergency surcharges on specified traffic; and in 1937 and 1938, in more permanent form on most articles of commerce. It is true that the present average revenue yield per unit of traffic is considerably below the pre-depression level; but only in small part is this result due to rate orders of the Commission, issued in the determination of specific rate controversies and largely offset by the authorization of advances in like controversies. In some measure, too, the lowered average revenue yield reflects changes in the character of the traffic carried and in the length of hauls; but predominantly it is the result of rate reductions voluntarily made by the carriers in response to competitive pressure. Vast numbers of charges are maintained by the railroads below the maximum levels authorized by the Commission, and the approval of further general increases might well prove tantamount, for the most part, to conferring authority upon the railroads, virtually without restriction, to exploit their monopoly power over noncompetitive traffic, and even with favorable financial results far from certain.

When the roads turn to wage reductions, by way of lowering their operating expense, they must resort to negotiation, rather than rely upon their own determinations or government action; and in view of the expressed declarations of the representatives of their organized employees, the process is likely to be a prolonged one and the outcome problematical. Since the purchasing-power theory of recovery has gained much headway, since railroad labor forces have been drastically reduced during the depression years, since these reductions have not been paralleled by readjustments in capital structures, since the present wage rates are the result of very recent agreements between the managements and the men, and since the added burden of operating expenses springing from these wage agreements, as

well as from increases in taxes and in prices of materials and supplies, has been expressly taken into account and sought to be offset in the latest authorization of rate advances, the railroads are faced by momentous obstacles in seeking to improve their position through the instrumentality of wage reductions.

As far as immediate relief is concerned, there appears to remain, therefore, only further reliance upon public credit. But a continuation, or even a liberalization, of the loaning policies of the Reconstruction Finance Corporation does not alter any of the controlling elements of railroad distress, nor does it provide any basis for eventual amelioration of railroad conditions. It may postpone or prevent some threatening bankruptcies, and it may be justified as part of the imperatively necessary achievement of reorganization of the railroad industry in the interest of soundness of finance and economy of operation, but in and of themselves these loaning policies merely put off the evil day, without constructive contribution to the removal of a crisis which, except for the degree of its gravity as affected by changes in general economic conditions, may readily become a continuing one.

The first essential of such reorganization involves a substantial scaling down of the capital liabilities of the railroads, together with a reduction of the fixed charges entailed by bonded indebtedness to limits adequately supported, even under conditions of slack demand, by the expanded and competitive character of the nation's transportation facilities as they exist today. Such a thorough housecleaning, however adverse its immediate impact upon security holders, would tend, more than any other single policy, to rehabilitate the credit of the railroads, particularly if it were accompanied, as it should be, by a more vigorous and far-reaching public control of current financial policies and practices. In face of the great severity and long duration of the business depression, large capital losses must inevitably be taken in connection with railroad investments, as with capital commitments throughout the maladjusted economy. In the present situation, the fact that the amount of railroad securities outstanding in the hands of the public is substantially exceeded by book investment in road and equipment, or by any physical valuation that may be placed upon the properties, is far less significant than the fact that the existing and reasonably prospective demand for railroad services, under prevailing transportation conditions, appears to be incapable of providing adequate support for that capitalization. That the heavy and inflexible burden of bonded indebtedness has constituted a major source of difficulty for the railroads has been amply demonstrated throughout the depression, and it is now reflected, despite much public assistance, in the accumulated defaults which have placed a large portion of the country's railroad mileage in the hands of receivers or trustees. In this connection, too, there is need not only of lightening the existing load of fixed charges, but of safeguarding the financial structures of the carriers more vigorously against undue multiplication of interest-bearing obligations, without orderly provision for debt retirement, in current financing.

If the interests involved perceived the wisdom of subordinating more or less barren existing rights to fruitful future possibilities, the scaling down of capital liabilities and the diminution of fixed charges might be achieved in some measure through voluntary readjustments, in connection with carriers which have thus far avoided formal financial embarrassment; for the most part, however, these objectives must be accomplished through the processes of receivership and reorganization, in connection with carriers which have succumbed to financial difficulty. Whatever justification there may have been for deliberately retarding these processes, through the use of public credit, during the earlier years of the depression, the painful but salutary readjustments patently required can no longer be postponed without jeopardizing the future of the railroads. It is essential that financial reorganizations be actively promoted; that dilatory tactics of managements or security holders be firmly repudiated, either through the existing tribunals or by means of new agencies expressly created to achieve expeditious results; and that governmental authority be directed to the adoption of reorganization expedients sufficiently bold to produce economically sound capital structures, grounded in the realities of the general transport situation and calculated to provide a reasonably stable basis for self-sustaining railroad operation. The practical difficulties involved in achieving such results are numerous and complex, since special

interests naturally resort to every available device for thwarting their accomplishment. But the mandatory subordination of these special interests is essential to the welfare of the railroads as well as of the users of their service. In the past the railroads have somehow managed to muddle through, despite the serious defects of financial reorganizations; at the present juncture, as one segment of a highly competitive transportation industry, it is doubtful whether they can withstand the mere opiate of feeble make-believe. Under the pressure of existing conditions the railroad industry will virtually have to remake itself in the course of the next generation; vast sums of capital will be required in the process; credit will be forthcoming only if the financial debris of past mistakes or past misfortunes has been effectively cleared away and capital structures are established which merit unquestioning confidence.

There is urgent need, also, as a second major policy, for recasting the operating organization and methods of the railroads, with a view, as far as practicable, to removing unnecessary duplications of services and facilities, eliminating wasteful competitive practices, and effectuating economies in the conduct of the industry. With the transformation of the railroad problem into a transportation problem in recent years, as a result of the rapid development of the newer carrying agencies, coördination has come to be widely accepted as one of the vital necessities of the transport situation. Achievement of this objective involves, of course, the extension of federal regulatory power to all the forms of transportation operating as public competitors of the railroads. The adoption of the Motor Carrier Act of 1935 constituted a significant step in this direction, and weighty considerations support the need for assertion of like authority over water carriers and air lines. A fully coördinated transportation system is of necessity dependent upon the establishment for all its constituents of an equality of status before the law, with the powers of control exercised by a single administrative tribunal, so that, as far as possible, particular transport agencies may neither enjoy artificial advantages nor be subject to artificial handicaps, and, in the interest of adequate service at reasonable cost, both the common and the distinctive problems of the various types of carriers may be accorded intelligent and harmonious consideration. But coördination within the railroad industry itself, for the elimination of waste and the achievement of economy through more unified organization and operation, appears to constitute, at this juncture, an even more basic essential.

The maintenance of competition among railroads, with transport operations carried on by a large number of independently functioning carriers, is in the American tradition, and it has contributed strikingly to the rapid expansion and refinement of railroad facilities and services. But this multiple ownership and competitive operation have also been prolific sources of waste and difficulty, and in the transport situation now prevailing they interpose serious obstacles to self-sustaining railroad operation. So deep-rooted was our traditional faith in the competitive principle that for more than three decades, after 1887, public policy directed itself to unrelieved enforcement of competition among the carriers, despite the fact that positive regulatory power was at the same time being sharply strengthened and enlarged, chiefly on the assumption that the railroad industry was a naturally monopolistic one. By 1920, in no small measure because of the fruitful war experience with railroad unification, resort by the carriers to coöperation and combination, under the supervision of the Interstate Commerce Commission, was expressly authorized—through pooling arrangements, acquisitions of control, and consolidations—but because of defects in the law and the dominance of competitive strategy, relatively little has been accomplished in these directions. In 1933, in face of emergency conditions not essentially unlike those now prevailing, the Federal Coördinator of Transportation was authorized to further, and under certain circumstances to compel, coöperative activity among the railroads, for the purpose of eliminating wastes and effectuating economies, but statutory restrictions upon diminution of the then-existing labor forces of the carriers rendered his efforts largely futile. While the estimates of investigators as to possible savings from various coördination expedients within the railroad industry vary widely, there is general agreement that enormous avoidable wastes characterize the existing situation and that large net savings are therefore possible, even if, during the transition period, reasonable provision is made for displaced labor. These savings may be

realized not only through actual consolidations, comprehensively planned, but in very substantial degree through pooling arrangements applied to equipment, shops, and certain types of traffic, and through unification of terminal facilities. Past efforts in all these directions have been rendered largely fruitless primarily because of an undue emphasis upon the maintenance of competitive conditions and because of public reliance upon the voluntary action of the carriers. Since the government is now clothed with vast regulatory powers and the railroads are now subject to an almost ubiquitous and vigorous competition from alternative transportation agencies, departures from the competitive principle and from competitive alignments appear to be justified in much more far-reaching measure than has traditionally been deemed to be safe or salutary; and since, under the voluntary provisions of existing law, the carriers have shown little disposition to subordinate their individual interests to common ends, the time appears to be ripe for resort to the processes of governmental compulsion. Such a reorganization of the far-flung railroad industry, particularly through a program of consolidation, calls for a balanced and orderly adjustment of numerous conflicting interests and must necessarily involve much time-consuming effort, even after the guiding legislative charter for this purpose has been established; but without such an operating reorganization, at least through the less formal coöperative arrangements, the foundations appear to be lacking for rendering the railroad industry reasonably self-sustaining and adequately prepared to integrate its activities, on a constructive basis, with those of an economically sound and technically progressive transportation system.

The vicissitudes of the economic breakdown and the pressure of the new competition have not been without beneficial effects upon the railroads. Under the spur of these conditions they have attained an increasing efficiency in the conduct of transportation and a forward-looking initiative in matters of service which promise well for the railroad future. The reorganization of financial and operating structures would supplement these gains very extensively, and it would tend to assure the continued dominance of the railroads in the field of mass transport. A national approach, embracing the railroad industry as a whole, is essential for this purpose; and if such an approach cannot be encompassed, under private management, in the reasonably near future, a transition to public ownership will become virtually unavoidable.

Remarks by the Chairman

Chairman Wolman: You have heard the paper by Professor Sharfman, of the University of Michigan, on "The Elements of a Railroad Program". Our next speaker will be Winfield William Riefler, Professor of Economics at the Institute for Advanced Study, expert on problems of currency and banking, at present adviser to the United States Treasury, a member of the Economic Committee of the League of Nations, and a participant in framing the housing policy of the present Administration.

Mr. Riefler will speak on "The Obstacles to Recovery in the Building Industry". Mr. Riefler!

THE OBSTACLES TO RECOVERY IN THE BUILDING INDUSTRY

WINFIELD W. RIEFLER

Professor of Economics and Politics, The Institute for Advanced Study, Princeton, N. J.

During the past year an extraordinarily sharp rise in building costs has terminated, at least temporarily, a promising revival in building activity and in doing so has paralyzed that arm of underlying basic demand that had been looked to more than any other to provide a broad and independent support for economic activity in this country in the years immediately ahead. The long upswing in business activity from the low levels of 1932 to the relatively favorable levels reached last year expressed itself in a general increase in output in practically all types of commodities, but was particularly marked in three categories of demand: first, automobiles and similar consumer durable goods; second, inventory expansion; and third, rehabilitation of our industrial plant and equipment. By early 1937 it was recognized in many quarters that these particular forms of expanding demand had very nearly spent their force. Current sales of motor cars, for example, were proceeding at a more rapid pace than could reasonably be expected to endure over a long period, and inventories of goods were reaching higher levels than seemed justified. Some contraction in the case of these two sources of demand consequently was in order. At the same time the most urgent undermaintenance and shortages of industrial equipment were in process of being filled. There were reasonable grounds, therefore, for expecting a recession from the early levels of 1937, a recession roughly comparable to that which occurred in 1924. There were also reasonable grounds for expecting that that recession would be neither long nor severe, since at the general level of activity reached in the spring of 1937, our economy had again attained a position where an expansion of productive equipment was justified, particularly in the case of the utilities. At that time, also, the railroads seemed to be emerging from the most acute of their depression difficulties. More basic and more important than either of these potential sources of expansion, however, was the vast field of housing which had at last become active after having lain dormant for seven years. Here was a broad, widespread basis for durable goods activity which was well situated to withstand the shock of a temporary recession, which was, in fact, capable of limiting a downswing in general activity to a purely recession basis. In contrast to these expectations, the downturn in construction preceded the general recession. It was, moreover, particularly marked in the case of housing.

In searching out the reasons why this was so, the following discussion has been directed particularly toward an examination of the problems of residential construction: first, because residential building is normally the largest single component in total construction activity; second, because many of the cost factors which affect the volume of residential building are common to the whole field of construction; and third, because the state of demand for new residential construction constitutes an important factor in the demand for other types as well. New residential building, especially in new areas, for example, leads directly to increased outlays for construction in the form of roads, sewers, schools and public utility facilities, and on occasion may also stimulate commercial, institutional and even industrial construction in such form as stores, movies, churches and factories.

The wide fluctuations that have characterized activity in this industry since the War can best be summarized by reference to the studies of Mr. David L. Wickens at the National Bureau of Economic Research. During the War, home building was curtailed and housing shortages were accumulated as a result of mobilization of labor and materials for military uses. There followed an exceptionally active period in which an annual average of more than 800,000 new dwelling units were constructed between 1922 and 1928. In the drastic slump that followed, the level of new construction sank to 55,000 units in 1933 and again in 1934. Revival started in the spring of 1935 and reached its highest point in the year ending with June 1937, when more than 300,000 units were built. Beginning

early last summer residential building again slumped rapidly and during the past few months has been again running at very low levels.

It is this latest revival between 1935 and 1937 and this latest slump beginning in the middle of last year that are germane to a discussion of current prospects for building. For this slump came at a time when conditions other than costs were highly favorable. It is important to emphasize this peculiar characteristic of the present slump because there is grave danger that it will be confused with the long, harrowing downturn in building that began in 1928 and persisted through 1934. It is only natural that this should be so. The collapse of the building industry during the depression was so complete, and its revival during the last two years was so belated, so short-lived, and failed so completely to develop the volume that had been hoped for, that the present slump has tended to become merged in the mind with that which was dominant only a little more than two years ago. In point of fact it is radically different with respect both to its underlying causes and to the factors which may be expected to lead to revival.

Let me illustrate this point, because it is vital to the analysis. The almost complete collapse of residential building between 1928 and 1934 was complicated by the cost situation, but reflected primarily a simultaneous breakdown in three other vital pillars upon which residential construction rests. First, the period 1928-1934 represented the ebb point in the residential building cycle that began in 1921; in other words, it was a period in which a sluggish rate of residential building was to be expected even had conditions outside the industry remained highly favorable. Secondly, the period from 1931 through 1934 witnessed an almost complete collapse in the mortgage market through which residential building is financed. Finally, these were also the years of the great depression in which rents sank to levels that made new building completely unremunerative, as consumer incomes were cut in half, marriages were retarded, and large groups of the urban population were forced either to double up or to return to rural communities. It was this concurrence of unfavorable factors, acting and interacting upon one another that converted the reaction in new building, which became acute in 1928, into a complete collapse of the industry. They operated with such severity that it was not until 1935, two years after the low point of the depression, that residential building activity began to reflect the general revival.

At that time the position of these three factors was again favorable to an expansion of activity. By 1934, for example, the surpluses of housing that had developed during the latter part of the preceding boom had been largely eliminated, partly by obsolescence and disappearance, through demolition, fire and flood, but largely because of the basic underlying trend of population growth. By 1935 our financial institutions were again in a position to finance residential mortgage construction, partly because of the general improvement in financial conditions and partly because of the widespread aid supplied by the Home Owners Loan Corporation. In that year, also, the Federal Housing Administration went into full operation. By 1935, finally, the general revival in employment and incomes had become sufficiently widespread to be reflected in rising rents, an undoubling of families, a reversal of the exodus of workers from urban to rural centers and an increase in marriages. In short, the three major factors in the downturn of residential building between 1928 and 1934 had again become sufficiently favorable to indicate the initiation of a new building cycle.

These three factors were still more favorable at the peak of the revival early in 1937, before the present slump in residential building activity began. At that time, the situation was not complicated by the current sharp curtailment of general business activity. On the contrary, the curtailment in building started at a time when general confidence was high, when business, employment and incomes were still expanding rapidly and were reaching the highest levels since 1930. Among the factors more immediately associated with real estate, furthermore, rents were rising, the volume of urban population was increasing, and the financial markets were developing constantly more favorable facilities for the financing of new construction. The current rate of building, furthermore, had nowhere near reached a level calculated to produce a surplus of housing. For example, the estimate given above of 300,000 dwelling units constructed during the twelve highest months

preceding June 1937 is below most estimates of the current volume of construction needed annually to take care of the current growth in family units. It certainly contributed little toward making up shortages of facilities built up in recent years through obsolescence, demolition, and loss through fire and flood. Our experience during the year demonstrated conclusively, however, that broadly favorable conditions such as these were not capable in themselves of withstanding the effects of such sharp rises in building costs as were experienced between November 1936 and May of 1937.

Any analysis of the causes of this rise in costs must necessarily be highly tentative because of the paucity of reliable data upon which to base generalizations. The most striking deficiency is the absence of a continuous series of comparable data reflecting the final cost of a completed dwelling unit including lot, roads, utility services and necessary appurtenances, on a site acceptable to the prospective owner-occupant, or tenant. It is this final cost and this cost only which expresses the relative importance of all of the subsidiary cost elements in the housing industry. It is also this final cost that is important from the point of view of general economic activity for it determines the effect of changing construction costs upon the demand for housing. It is almost impossible, however, to ascertain the trend of these final costs on a nation-wide basis, because it is impossible to find a continuous sample of comparable transactions upon which to base one's estimate. The building industry is highly decentralized. It produces a product that is subject to constant modifications calculated to meet the particular needs of each individual situation. The market for houses cannot be quoted, consequently, with anything like the precision common to the market for other commodities.

In the absence of conclusive data upon this vital aspect of the subject, one is forced to rely upon subsidiary data such as that compiled by the Bureau of Labor Statistics covering important elements in housing costs such as building materials and labor. So far as these go, they show a movement in building costs that parallels rather closely the general rise in costs during the same period. Between the second quarter of 1936, for example, when costs were sufficiently favorable to permit a rapid expansion in output and the third quarter of 1937 when it became definitely clear that housing was entering into a new slump, wholesale prices of building materials rose by 12 per cent. This exceeded by a small amount the comparable rise in wholesale prices of finished commodities which advanced by 10 per cent, and was one fourth less than the rise in prices of raw materials as a group between the lowest quarter in 1936 and the highest quarter in 1937. During the same period, according to the Bureau of Labor Statistics, average hourly earnings of labor in the building construction industry rose by 15 per cent. This rate of increase was exactly the same as that which took place simultaneously in manufacturing as a whole, where average hourly wages in the durable goods industries rose by 17 per cent on the average and wages in industries producing nondurable products rose by 11 per cent. So far as these two widely quoted series indicate, therefore, the rise in costs of building materials and building labor during this critical period was average rather than exceptional. Building materials at wholesale, being less adapted to purely speculative movements, rose less than raw materials, but by about the same amount as wholesale prices in general, and building labor showed a smaller rate of increase in hourly earnings than in those industries such as automobiles and steel, where labor troubles were acute, but one that was equivalent on the average to the increase in manufacturing employment as a whole.

As the analysis proceeds beyond the basis of these more reliable data, however, striking divergencies appear which differentiate sharply the cost situation with respect to building from the general problem of mounting costs with which American industry has been confronted during the past two years. In the first place, outside of housing, price changes of most commodities at retail showed only a pale reflection of the sharp increase in costs of raw materials and labor. Cost of living indices show rising retail prices during this period when wholesale prices rose by nearly 12 per cent and hourly earnings of labor by 15 per cent, but the percentage increases appear to have been much smaller on the average. In the case of residential construction, on the other hand, although the evidence is admittedly scanty, the percentage rise in final costs to the purchaser of a completed home appears to have been

larger rather than smaller than the 12 to 15 per cent increase noted in wholesale prices and hourly earnings. Secondly, it would appear that the rise in final costs of a completed dwelling unit varied widely between different localities and tended to be more abrupt in those sections where expansion of building activities was greatest; in other words, where potential volume was most promising. Finally, the operation of these two divergencies together apparently produced a third striking difference with respect to their effects upon general business activity. In the case of housing, mounting costs appear to have operated directly upon the consumer and to have led to a slump in business activity because of the resistance of the consumer to the increase in prices for new housing accommodation. In the case of most other commodities, however, where retail prices advanced less than costs of labor and materials, sales at retail were better maintained relatively than in real estate, and mounting costs affected business activity primarily by inducing producers to defer postponable expenditures in an effort to maintain profit margins.

It is possible that the explanation of these divergencies is purely mechanical, that they are due to incomplete data and misleading statistical information. It is possible, for example, that quoted prices for building materials do not reflect accurately changes in costs of these materials to contractors. It is also possible that the sample of contracting firms upon which the figures for labor costs are based is not representative of firms engaged in purely residential construction. To the extent that the divergencies noted above are valid, however, they point either toward the presence of semi-monopolies in the building industry or toward a genuine strain in 1937 upon its productive capacity. In a sense probably both were operative. The building industry is highly unionized in many areas and its contracting and supply units have also been charged with monopolistic practices. At the level of promotion and sale to consumers of individual, completed dwellings, however, the building industry is probably as highly decentralized and highly competitive as any major industry in this country today. If, under these conditions, the rise in final costs to consumers of completed dwellings was actually greater than the concurrent rise in costs of materials and labor, it would indicate that developers were faced with genuine shortages of capacity which limited the flexibility of their operations, diminished the possibility of evading cost increases through substitutions and forced the use of less efficient labor.

The aggregate volume of construction developed last year fell so far below that which was prevalent during the nineteen-twenties that it seems preposterous at first glance to explore the possibilities of a general shortage of capacity in the building industry. It is a highly decentralized industry, however, characterized by a great number of relatively small production units which between 1930 and 1935 passed through a period that can be described as near starvation. In the process there was probably a considerable deterioration both in supply capacity and in personnel of contracting organizations. The supply of skilled labor also shrunk, reflecting the passing of older workers from the industry, the transfer of many of the more alert workers to more stable occupations, and a dearth of accessions of new workers, effected in highly organized areas through a restriction on apprenticeship. All of these factors would tend to cut down the efficient productive capacity of the industry toward some point where rapidly rising volume would result in sharply rising costs. In the two years between the spring of 1935 and the spring of 1937, residential building did undergo a sixfold expansion, from an annual rate of 55,000 units to one of over 300,000 units. In an industry as localized and loose-jointed as building, such a rapid rate of expansion, even though the final volume was low, undoubtedly developed bottle-necks at numerous points.

Whatever emphasis one chooses to put upon the relative importance of the various cost increases which succeeded in the aggregate in reversing the trend of construction last year, it seems clear that the intervening months have brought some correction and that from a purely short-run viewpoint the industry is in a somewhat better position to go ahead. Such bottle-necks in capacity as existed last year, for example, have been removed by the slump and no longer constitute an immediate deterrent to a resumption of building activity, since contractors are again in a position to utilize less costly materials and more efficient labor. Official computations show, furthermore, that the rise in building wages has leveled off and that

wholesale prices of building materials have undergone a distinct recession. There are also rumors in the air of kickbacks and concessions which may have caused a sharper drop in unit costs both of labor and materials than is revealed in the official compilations. As evidence of readjustment we have, therefore, an increase in efficiency, some drop in unit costs, and the elimination from bids of charges formerly required as protection against cost increases that might be incurred during the process of construction. In addition, the recent amendments to the Federal Housing Act have materially lowered the real cost of financing both for home owners and for developers of multiple family projects, and at the same time have expanded the potential market for home ownership by lowering down payments and stretching the maximum period for amortization of mortgage commitments. All of the various cost and financing factors, therefore, have, at the least, moved in a direction favorable to a resumption of residential building. On the other hand, the potential market which existed last year has undoubtedly suffered from the general industrial setback. It is still too early to tell whether present costs are sufficiently favorable to permit revival in the face of this sharp impairment in the general industrial situation. Recent straws in the wind, such as the unexpectedly heavy rate of applications for mortgage insurance under the new terms now provided by the Federal Housing Administration, may indicate a stronger public demand at current prices and terms than recently seemed possible. Such a development would not be inconsistent with the experience and tradition of the industry. In 1921 and again in 1924, for example, the residential building industry showed its ability to initiate a revival in the face of a declining industrial situation.

Up to this point the title of this paper, "Obstacles to Recovery in the Building Industry", has been interpreted as applying to the various short-run obstacles which brought about the downturn in residential building that began early in 1937. It may also be interpreted, however, in quite other terms than those adopted above: it may be read to ask "What are the long-run obstacles to a sustained revival in building activity, a revival capable of contributing material improvement to our housing accommodations as a whole, and, in particular, capable of meeting the growing indignation of the commuunity over sub-standard housing conditions?" The obstacles to a building revival capable of meeting these tests have not been touched upon above—they are much more deep-seated than any of the factors there mentioned and will require for their removal drastic readjustments both within the industry, and in the economic environment within which the industry functions.

From a long-term point of view, the residential construction industry of this country has developed in a highly sheltered environment. Bulwarked by a rapid rate of population growth, from immigration as well as natural increase, it has enjoyed a market that was in a continuous process of expansion. This has persisted since the founding of the country, and it has constituted a prime sustaining factor for the industry, in bad times as well as in good. Within this expanding market, furthermore, housing has enjoyed the advantage of being a necessity because the population had to be sheltered. It could not forgo housing in the same sense that it could economize on luxury goods. It is not strictly true, of course, that residential building must inevitably expand concurrently with a growth of population. A certain amount of contraction in space requirements through the use of smaller houses, smaller rooms, fewer facilities, doubling up, etc. is always possible, and can frequently be seen in operation when housing costs rise too far out of line in relation to incomes. By and large, however, the housing industry has depended almost solely, in this country, upon an expansion of population for an outlet for its product.

Under cover of the protection afforded by this rapidly expanding demand, various practices have become associated with real estate that would be utterly inconsistent in a more exposed industry—practices, furthermore, which will tend to become serious obstacles to sustained building activity as the rate of population increase diminishes. Real estate has traditionally constituted, for example, a prime vehicle for speculation, as well as a principal outlet for investment. A century of rise in real estate values has permitted local communities, furthermore, to depend upon the taxation of real estate for the bulk of their revenues. It has permitted lax methods in the handling of real estate finance, and lax methods in the zoning

and planning of cities. Finally, it has permitted highly inefficient practices to become imbedded within the organization and structure of the building industry itself.

That construction methods have failed to keep pace with the technical improvements that are generally characteristic of American industry is notorious. The typical assembly unit in the building industry, for example, has remained small in spite of the fact that it markets one of the most expensive commodities our economy demands. This is in sharp contrast to developments in manufacturing where large, well-capitalized producing units devote huge capital resources toward the development of economies in the production of commodities that retail for relatively small amounts. An operative builder, consequently, is distinctly limited in his ability to underwrite experimental research in new methods of production and to train workers to adopt such methods even after they have appeared. He is not in a position to cut costs through mass purchasing of materials but must be content to pay the high distribution costs that characterize small-scale distribution. He has not been able to adopt mass methods of assembly. Because failure on any one operation may involve losses sufficient to impair seriously or even to wipe out his capital resources, he has been forced to rely upon highly skilled craftsmen and has not been in a position to experiment with economies that result from the dilution of skilled with unskilled labor. Finally, because he could not promise regular, steady employment at an adequate annual wage, he has been forced to accommodate himself to forms of unionism that further impede his flexibility in adapting himself to new conditions. The high unit costs, utterly out of proportion to the resulting annual incomes that pervade the construction industry because of the archaic nature of its craft organizations, their jurisdictional disputes, and their rules for the protection of jobs, are sufficiently well known to require little exposition in this paper. In all of these respects and many more, practices in the building industry differ widely from those characteristic of technically advanced American industries. These practices could have evolved only in a sheltered setting. That they have maintained themselves at all constitutes a striking testimonial of the advantages which the industry has enjoyed because of the expanding markets afforded by the constant growth in population.

That growth is still in process at the current juncture. It constitutes, in fact, our most compelling reason for expecting that we are now going through the initial stages of a new building cycle. Already, however, there are signs that the force of this factor is beginning to diminish. For even though the annual increase in new family units requiring shelter is still large and will require a heavy rate of new building over several years, it comprises, today, a much smaller fraction of the existing population than was generally characteristic during the last century. The community, consequently, is in a much better position than formerly to resist high housing costs through economies in its use of space.

Within a measurable period, on the other hand, this factor of growth will cease to exercise its effects. There is abundant evidence to indicate that our population is stabilizing and that within the lifetime of many of us present today, the construction industry will no longer enjoy the advantage of a constant increase in the aggregate demand for shelter. This will constitute a major shift in its environmental situation. For example, the problem of overcrowding as such will tend to disappear. The problem of obsolete and sub-standard housing will tend to be accentuated. In these circumstances, the ability of the industry to survive will depend upon the extent to which it is able to develop a replacement demand for housing, that is, the extent to which it will be able to offer consumers sufficiently attractive new housing at sufficiently reasonable costs to induce them to incur additional housing expenditures rather than remain content with older housing at lower costs. This is a problem which the industry has never faced in this country. There has, of course, been some replacement of dwelling units in the past. In the main, however, it has been limited to replacements required by the growth of commercial areas. The great bulk of new building has constituted a net addition to our housing supply.

Within a measurable period, therefore, the building industry will encounter hazards which it has never faced before. These same hazards, however, also present an opportunity which the industry may exploit, provided that it can gain control of its

internal problems. The cessation of population growth in itself tends to a certain extent to create a potential demand for replacement of housing, since smaller family units have a larger margin of income available for expenditure on semi-luxury products. The ability to afford modern housing consequently will extend farther down the income scale than has been true in the past when the bulk of the income of most families was required to meet elementary needs for food, clothing and minimum shelter. To avail itself of this opportunity, however, the building industry will have to be technically qualified to compete for the consumers' dollar on a parity with more advanced industries such as the domestic appliance industry, the automobile industry, and the vacation industry. It is extremely doubtful whether it could meet the test of this competition today.

The building industry is, of course, not unaware of the opportunities implicit in this situation, and also of the obstacles it must overcome in order to survive. It is, in fact, in a state of ferment. There is widespread experimentation in progress into new methods of construction and improved techniques of organization. Traditional patterns of housing finance are in flux; governmental bodies are beginning to concentrate on the complicated problems of community planning, slum clearance, and housing for families of low incomes; and there are scattered evidences in various communities of attempts to reapportion the burden which real estate bears in local taxation. In the longer view, the future of building is inseparably linked with the relative degree of success or failure that attends these efforts. For drastic changes in the fundamental structure of the industry will be required to meet the new environmental conditions that are emerging and to overcome obstacles to survival of a much more obstinate and basic character than those which are current today.

Remarks by the Chairman

Chairman Wolman: Our third speaker will be Isador Lubin, United States Commissioner of Labor Statistics, formerly of the University of Michigan, and a member of the Brookings Institution, author of books and articles on unemployment, the wages of coal miners, the unemployment policies of England, and a distinguished public servant. Dr. Lubin will talk to us on "The Labor Situation as a Factor in Business Recovery". I have the pleasure of introducing Dr. Lubin![1]

[1] *Cf. infra,* p. 112 *et seq.* for the paper presented by Dr. Lubin.—Ed.

Remarks by the Chairman

Chairman Wolman: We have had three main papers of this morning's session, and shall now proceed with the discussion.

The discussion will be opened by a practical economist, now a member of the firm of Wellington & Company. For many years he was the Administrator of Finance in several countries of Latin America. I have the pleasure of introducing Dr. William W. Cumberland!

DISCUSSION: IMPACT OF REFORM ON RECOVERY

William W. Cumberland
Economist, Wellington & Co.

Mr. Chairman, Members and Guests of the Academy: The program states that the topic of this morning's meeting is the "Impact of Reform on Recovery". Now if I understand the meaning of the word "impact", it means to hit, and so I assume that reform has hit recovery. That is apparently what is the matter.

At all events, reform has been kept very closely under the blanket this morning. We have not heard much about it, and I wonder if that would imply by any chance that the reformers are not quite so much convinced as they were, perhaps, two or three years ago that reform and recovery are synonymous.

Now to discuss some of the papers and the points that were brought up, it seems to me that Professor Sharfman gave a comprehensive analysis of the railroad situation, pointing out the very real difficulties in which that great industry is involved, but as to the remedies it seems to me that some questions can be raised.

Professor Sharfman, of course, made the usual point about the necessity of shrinking the railroad capital structures. He failed to mention that there has been physical valuation of railroads; that such valuation was an accepted policy of government; that railroads, at least by implication and possibly by law, were to be allowed by the Interstate Commerce Commission to earn profits on such valuation which would have prevented the financial difficulties in which the railroads as a class now find themselves.

I do not know why Professor Sharfman neglected to mention that, but it does seem to me that the failure militates very strongly against the conclusion which he reached in regard to the desirability of reducing capital structures. He proposes, "Let's clear away the debris, put the railroads in sound position, so that they can obtain adequate new financing." Some of you in this room may be holders of railroad securities. You are aware that on the basis of most careful and expensive evaluation, it has been determined that the physical value of the properties far exceeds the nominal value of the securities which have been issued and, of course, infinitely exceeds the present market value of railroad securities. So you are told, "Go through the wringer, take your medicine, and then you will be in a happy frame of mind to put further money into the business."

We are also told that the railroads are suffering from new forms of transportation. Has it occurred to you that these forms of transportation are on the whole unregulated, and that, perhaps, that is the reason why they are able to compete so successfully against the railroads?

I, for one, am hardly willing to see our magnificent aviation industry, a model of progressiveness in ingenuity of design and efficiency in transport operations, brought under official regulation so that it will have what Professor Sharfman described as the inefficient and unprogressive record which the railroads have enjoyed under regulation, resulting now in actual or threatened bankruptcy on a wholesale scale.

Professor Sharfman also failed to mention the effect of working rules. This is not the time to discuss in detail the working rules of railroads, but in a general way I will give just one or two examples. For instance, a certain railroad with whose operating policy I am quite familiar found some branch lines unprofitable, particularly as to passenger traffic, and found that by substituting for the existing passenger trains a Diesel-powered single car those lines could be turned from a loss to a profit. Arrangements were being made to take that action when the Railroad Brotherhoods stepped in and said: "Certainly. Of course. That is fine. But you must recognize that a train is a train, and you must have on your new, single Diesel car a full crew, consisting of an engineer, a fireman, a conductor and two brakemen—a complement of five." That made the difference between a profit and continuation of the loss, so all of the passenger service was abandoned, and whereas one or maybe two men could have had jobs, five for each train were thrown out of jobs.

As a second illustration, in the earlier days of railroading one hundred miles was considered a fair day's run for freight service, and it was. But with increasingly improved rolling stock and motive power, roadbeds and the like, higher speed became possible, and the railroads naturally were able to run much further than one hundred miles for an average day. But one hundred miles continues to be the basis for the payment of one day's compensation to railroad employees. For a day's work a train crew may receive two or three days' pay, and the public foots the bill. It seems to me that in looking for a remedy for the railroads these working rules of unions might be examined, and yet, even among the railroads, I find no inclination to raise that point and to seek the very real and very considerable economies which are possible in that direction.

I meant to call your attention to the position of the railroad debt in the financial community. We all realize that it has been almost impossible for railroads to obtain equity capital for a long series of years. Consequently, such small amounts of new capital as have been obtained have been on a debt basis, with the result that the proportion of debt to total capitalization in railroads has consistently increased. This is thoroughly bad financial practice, but inescapable because of the shadow of government regulation.

But who are the buyers of railroad bonds? Who are the holders of this debt? They are our savings banks, our insurance companies, the trust funds of persons who have died and left their funds to beneficiaries who may not have great business experience—in short, those who depend on protected rather than enterprise capital. These are the investment funds, the endowments of our colleges and universities, the assets of our savings banks and insurance companies, which Professor Sharfman is now proposing to invalidate.

We ought to find some other solution for a great and essential industry than destroying the accumulated property of the community. It seems to me pertinent to remember that the freight rates of the United States are the lowest of any major country in the world, with the exception of Japan. That does not mean that our railroad wages or other operating costs are lowest. Our railroads must be credited with operating efficiency. They must represent very real service which capital invested in railroads has rendered to the community. Now Professor Sharfman proposes to render this capital obsolete.

If the present railroad system of the United States is furnishing almost the lowest priced transportation in the world, is not that alone sufficient reason for seeking a solution for the railroad problem outside of the destruction of the very capital which has made that record possible? How about trying less government regulation instead of more?

Dr. Riefler told us how the building industry went up the hill and then went down again. He has correctly stated that the construction industry is on a small-scale basis. He has failed to comment that it is a little difficult to ship houses around over the country, and that it seems necessary to build them on the spot where they are wanted. Therefore, it would seem an almost impossible problem of financial and industrial enterprise to create great organizations for the construction of housing.

I wish to congratulate Dr. Riefler for failing to present the British housing boom as an example which should be followed in the United States. Great Britain has now, in a period of five or six years, built housing which in my judgment is adequate for somewhere between thirty and fifty years, and hence has assured a thoroughgoing depression for that country. Already much of that housing is coming back on the builders; people are unable or unwilling to go through with their commitments; they are losing their equity. At least we have been spared the suggestion that a similar policy should be followed in this country.

I noted as both Dr. Riefler and Dr. Lubin were talking that industries in which there has seemed to be the greatest distortion of labor costs and of the prices of the commodities involved have been those industries where (a) there is the greatest degree of unionization, or (b) where there is the greatest degree of government control. I do not know whether any generalization could be made on that record or not, but it does offer an interesting subject for further consideration.

Presumably most people in this room are aware that there are differences in wages between the North and the South in this country, and even between various industries. I was hoping that Dr. Lubin would address himself to some of the very real problems in labor relations which puzzle the minds of many of us. We have a Wagner Labor Act, and we have a National Labor Relations Board, and both the Act and the Board would seem to have had some effect on sustained recovery. But on that question, unfortunately, we heard nothing.

Another gap, it seemed to me, in Dr. Lubin's presentation was in failing to attempt to make a correlation between the man hour output which he discussed, and technological improvements, largely represented of course by additional capital which has gone into the various industries.

From the economic point of view, I think that "man hour output" is distinctly an open question. Steel-making, for example, used to be a rough, hard, rugged task; now almost all of the processes consist in pulling levers or touching buttons. Can it be said that the increasing output per employee, if any, is really an effect of labor efficiency for which labor should receive higher hourly compensation? Rather, might it not properly be stated that here is technological improvement, the benefit of which should properly go to the community at large after proper participation by labor and after proper payment for the capital which has made the improvement possible? But some of our labor friends seem to take the position that all of this increase is due to greater efficiency of labor alone, and hence labor as such should receive the entire benefit of the improvement.

While we have had a scholarly and thoroughly enjoyable program, I still wish that we had heard something on the problem of the "Impact of Reform on Recovery".

PART II

ESSENTIALS FOR SUSTAINED RECOVERY

INTRODUCTION *

LEON FRASER, *Presiding*
President, The First National Bank of New York
Trustee, Academy of Political Science

LADIES and Gentlemen: It is my privilege on behalf of the Academy of Political Science to welcome you to the luncheon today.

Our topic, "Essentials for Sustained Recovery", implies by its wording that the abrupt reversal of the recent recovery movement is attributable to the absence of some fundamental requisites that constitute conditions precedent to any truly *sustained* advance.

What is the essential prerequisite for want of which recovery was arrested and for the lack of which we have receded into new depression? After reflection, many answer that the essential essential which must be present is a coöperative spirit of mutual understanding and mutual helpfulness between government and enterprise, both sharing a common economic philosophy, and both in harmony upon the guiding principles of the American political and social system.

No one can honestly say that any such mutuality exists today, nor can anyone honestly say that government itself has fixed its economic and social philosophy, either by consistency of action or consistency of speech, in such a manner that enterprise can comprehend what that philosophy is, or can reasonably conjecture what may happen next.

No one can honestly say that enterprise has done all it ought in realizing the mighty burdens that hamper government or in

* Opening remarks at the Semi-Annual Luncheon Meeting.

recognizing the world-wide social changes that have recently evolved, or in endeavoring by counsel to reëstablish in a coöperative manner the bases of satisfactory relationship between itself and government.

Until progress is made in this direction and government ceases to vilify and obstruct business, and business ceases to denounce and belittle government, any assurance of *sustained* recovery seems vain.

Both of our speakers know intimately government and enterprise and the difficulties of each. They lament the existing chasm and they are eager to eliminate the causes that have brought it into being, and eager to effect those changes in attitude and action that are necessary to bridge that chasm.

Perhaps they have the answer to the query, "How can business and government again be brought to coöperate in understanding and in helping each other, thereby releasing the real essentials of any sustained recovery?"

I first introduce an outstanding American citizen endowed with a highly trained and gifted mind, ripened by large experience in public and in private affairs, a practical business lawyer who has long been a student of all our economic problems, an active progressive in thought and politics since the days of Theodore Roosevelt, a specialist in recovery, sustained and unsustained, because in his responsible official rôles during the administration of the National Recovery Act he has already recovered us once. Mr. Richberg!

ESSENTIALS FOR SUSTAINED RECOVERY

DONALD R. RICHBERG
Former Chairman, National Recovery Administration

THE topic of the day has an engaging simplicity. But the discussions arranged for the morning and the afternoon seem designed to obscure the hard, grim nature of essentials in a protective fog of expert opinion and detailed analysis of particular problems. What should be done about public utilities, railroads, the building industry, labor and unemployment, monopoly and competition, the uses of capital, and the distribution of wealth and income? If a sustained recovery is to wait upon a satisfactory settlement of these questions, we might as well "eat, drink and be merry, for tomorrow we die".

So the astute program makers have provided a period of physical nourishment and mental relaxation in which a couple of seasoned politicians may discuss the political forces that will guide us without economy to a political economy and without science to a political science. What government *ought* to do or *ought not* to do is a subject for endless debating. But what government *can* do and *will* do depends very largely upon effective public demand. The unscientific measurement of that demand is an art of politics.

In a democracy, enjoying the educational infection of public schools, free press, free speech, incessant radio and universal movies, we know a great deal about what people want. But we find it hard to agree upon what we can get, or how we can get it.

We all want freedom, security and the abundant life. But no one can enjoy freedom without having other people restrained from injuring him by force or fraud or oppression. No one can enjoy security in this interdependent world unless he can exchange his service for the services of thousands of others upon whom he relies for a constant supply of food and other daily necessities; and all too few can enjoy an abundant life unless we can organize our productive-distributive system so efficiently and fairly that at least the vast majority of able-bodied persons can earn a good living.

The primary object of national effort, upon which a democracy can be most easily united, is the greatest good of the greatest number. If we seek progress in this direction, then some measure of individual freedom, individual security and individual gain must be sacrificed in advancing the freedom, the security and the prosperity of the people as a whole. There is, of course, a world of difference between a democratic program of organized self-restraint in aid of an individual pursuit of happiness, and the iron rule of a fascist, a communist or a totalitarian state which forces the sacrifice of individual freedom in the pursuit of collective security and prosperity. Under the democratic ideal the state exists to serve the individual. Under the prevailing alternative ideal the individual exists to serve the state.

In discussing today the essentials of a sustained recovery, let me reassert my faith that a recovery can be sustained in the United States without the sacrifice of our institutions and ideals of political and economic freedom.

Let me also reassert my conviction that a recovery cannot be sustained without the voluntary sacrifice of some of the individual liberties hitherto enjoyed, in order to maintain a necessary coöperation for the common good. Please note that I speak of *voluntary* sacrifice. That does not mean that the protection and progress of an industry or the entire nation must wait upon the convincement of every stubborn person who is unwilling to play his part in a coöperative program. I mean that there must be a willingness on the part of the great majority to discipline themselves before any compulsory measures are adopted. I mean that a preponderant public opinion must recognize a need to subordinate self-service to public service before a democratic people should attempt to impose legal obligations.

One of the greatest obstacles to a sustained recovery is the mental difficulty that so many business men, bankers and politicians have in conceiving that safe coöperative controls of a competitive system can be evolved. Their fears paralyze their imagination. Persons fearful of concentrated money power

have visions of an ultimate monopolistic control of commerce. Persons fearful of centralized political power have visions of an ultimate governmental control of business.

As a result, public opinion is made suspicious of every effort to establish any responsible controls of our industrial system. Politicians incite consumers, workers and small business men against every private project for the self-regulation of business; and business leaders look askance at every governmental call for coöperative service. Of course, it is foolish to trust everyone, but it is more foolish to trust no one. It hurts to lose faith in people, but it hurts more to have no faith.

As a matter of cold fact, business men and politicians, who understand the interdependence of all business, all workers and all property owners in an industrial civilization, must know that we have only two choices: *We will get together or get nowhere.* Either we will establish democratic, coöperative controls in time to avoid the collapse of an anarchistic competitive system, or we will drift into disaster and then seek salvation through accepting dictatorial controls.

What are these coöperative controls of which I speak? How should they be organized and employed? With great pride I assure you that I do not know. I have arrived at that Alpine height of wisdom where I am aware that no one man knows or can know how all industry and trade should be organized and operated.

In the last few years I have had an extraordinary opportunity to learn about the major problems of our major industries. Coöperative efforts to meet those problems are urgently necessary to preserve continuous operation, to promote expansion, and to protect workers, investors and consumers.

This need exists in large and small industries, and concerns all enterprises whether big or little. But any effective program must come from the composite wisdom and the common purpose of those who are to execute it. In many cases we have no present assurance that a majority want anything except the maintenance of a well-sanded arena in which they can cut one another's throats in a free-for-all exercise of individual liberty. Some of them, however, also want the government to arm them with battle axes and to restrict their competitors to wooden clubs.

But this is not a discouraging situation, because it has never been possible to tell how many people prefer a rule of reason to a rule of force, until a rule of reason has been tried. So long as trial by combat was accepted as the simple, manly way to settle all conflicts, it was difficult to establish civil government. Now we are gradually learning that civil government must rest on the economic foundation of civilized competition—a competition made tolerable, and directed toward social progress, by coöperative controls.

How then are we to establish such controls? How are we to achieve this essential of sustained recovery? Not by regulatory legislation. As the President said so forcibly in his last annual message, we cannot " conscript coöperation ".

Let it also be emphasized that coöperation, whether between business groups, or between management and labor, or between business and government, does not mean that Jack makes the plans and George carries them out, that Jack issues orders and George obeys. Coöperation means that people plan together how to work together, and then do it.

A democratic government seeking to preserve a system of free enterprise cannot require men to work together, cannot by law coördinate the units of private business into an industrial machine, cannot establish a centralized control of business management. A democracy cannot regulate a competitive system so as to enforce such obligations of public service as can be imposed upon a public utility monopoly. But a democratic government can foster the creation of self-governing controls and can safeguard the public interest against their misuse.

A democratic government can and should preserve the freedom of every trade and industry to regulate itself to the full extent of its capacity for self-government. A democracy should resort to political regulation only when necessary to protect the public from the abuses or failures of voluntary coöperation.

In such a governmental policy there would be no place for punitive taxation or other devices to destroy initiative, efficiency and economy in business and to preserve inertia, incompetence and waste. Under such a policy a government would not try, at the same time, to cripple competition, to compel concerted action and to make coöperation a crime. A consistent governmental policy of encouraging organized self-help and self-discipline in advancing the general welfare would not destroy, but would preserve, individual liberty. Coöperative private enterprise is today the servant of individual demand.

You press a button on the wall and an electric bulb lights your room. Your individual need is satisfied by individual action. But you have at your service a vast, intricate organization of men and things, created to meet instantly the needs of thousands of individuals. Day and night that organization must operate under coöperative controls. This production and distribution system depends on the continuous flow of material supplies, on the continuous employment of workers, on the continuous operation of banks, on the continuous purchasing power of customers, on the continuous protection of government.

In a word, your individual freedom to enjoy light or darkness at your individual will depends on the voluntary meeting of voluntary obligations assumed by thousands of men playing their accepted parts in a great coöperative enterprise. But no amount of good will and honest effort will create a responsible enterprise unless all of those engaged yield some of their individual freedom of action to the control of others.

We all know that as a single business grows, and becomes more and more dependent on other businesses, and more and more consumers and workers become dependent on it, the need to develop and maintain adequate controls to insure continuous production becomes more and more a matter of public concern. We all know that the unbroken operation of a public utility must be insured—that a community cannot tolerate stoppages that would deprive it of light or water. But the continuous production and distribution of other necessities of life are equally essential.

We cannot live without food; we must have clothing and fuel and shelter; and, as an underlying necessity, in order to have money with which to buy the things we need, we must have gainful employment. Thus when opportunities of employment cannot be found by millions of people, in a nation with resources sufficient for the comfortable support of the entire population, the primary need for a sustained recovery is too obvious for discussion.

That primary need is the creation of adequate controls within each trade and industry, bringing some coördination into the entire industrial system, so that each unit of free enterprise, while retaining all the freedom of the individual worker, may, at the same time, be able to serve as a coöperating member of an organized and orderly society.

No one whose imagination is paralyzed by fear can be expected to agree with, or even to understand, this statement of the first essential of a sustained recovery. If a man's favorite nightmare is monopolistic big business, he may be expected to wake up tomorrow shrieking: "The Fascists are coming! Beware! Beware!" If his favorite horror is government bureaucracy, he may be expected to rise from haunted slumber shouting: "Down with Communism!"

Alarmists of both varieties may be expected to make so much noise that they will be unable to hear either counsels of moderate reform or the mutterings of despair among millions who are weary of waiting for the sunrise. If we are to make progress toward a sustained recovery, we must appeal to those whose ears are not filled with their own shoutings of fear and hate and prejudice. We must turn to those who understand that every program of human coöperation for the common good can be made an instrument of oppression and tyranny; but that only by coöperation under faithful leadership have human beings advanced themselves from the cruel hardships of a brutal struggle for existence to the ever-widening opportunities of modern civilization.

True it is, that every agency of human progress can be converted into a machinery of self-destruction. True it is, that every extended power of the human hand and brain can be misused to injure, instead of to help humanity. True it is, that religion and science and education can be made instruments of tyranny and selfish ambition, instead of public service. But is that any reason to forswear the use of coöperative methods, or to deny ourselves the aid of machine power and collective man power, or to outlaw religion, science and education?

Self-degradation is neither conservative nor progressive doctrine. The conservative seeks to hold what has been gained. The progressive seeks to gain more. Each renders useful

service. The radical is a progressive in such a hurry that he cannot stop to think. He is an irritating stimulant.

But the perennial obstructionist, an assured obstacle to democratic progress, is that timid creature who objects to every enlargement of human power on the ground that it will be abused. By bellowing against everything big, by snarling at every great organizer of human effort, by denouncing every large organization of collective power as a conspiracy against individual liberty and a menace to the security of little men, this obstructer covers up his own sense of inferiority, his own inability to grapple with large problems, his own suspicion of the good motives of anyone big enough for a big job, so that he may pose before his own mirror as a deep thinking guardian of the general welfare.

In truth, he is a dangerous enemy of the institutions and the people whom he believes he is protecting. He is the embodiment of an ancient fear of primitive men—that fear of a power beyond their understanding and beyond their control, which might destroy them. That fear was nourished for centuries when human working organizations were usually held together by organized force and when men worked together under the lash and not by voluntary association in a common task.

The democracies of the world arose after centuries of hard education had taught civilized men two lessons: First, that they could accomplish infinitely more by working together than separately; second, that they need not have masters to force them to work together and to appropriate the lion's share of the product. They learned that they could associate themselves together as free men and agree upon a fair division of the rewards of their joint enterprise.

In this civilized understanding of the need and value of coöperation, in this civilized faith in each other, in this civilized fulfillment of contract obligations, human beings created the institutions of self-government and free enterprise that have brought them in two centuries further from the poverty and slime and cruelty of brute existence than they had come in all the centuries before. The fabled glories of Greece and Rome make a miserable showing of the meanness, the misery and the ignorance of common life, when compared with the magnifipresent greater and more complex population and, for a few years to come, the rate of its annual increase; and notwithstanding, also, the displacement of workers by improvements in machines and the availability of mechanical power?

Men live by means of the production of wealth, and if the modern machine appears to displace workers, let us remember that that is but one side of the picture; the other side shows the machine as multiplying man's capacity to bring forth annual wealth. The more machines, the more mechanical power, the more wealth and, therefore, the better the livelihood. Our problem here so far from being one of despair ought to be one of hope. It demands adjustment of which we ought to be capable—adjustment to the new means of multiplying man power and the production of annual wealth.

One may inquire at once: What are the terms of that adjustment? To be sure there is no formula in such a matter. Generally, one may say that it will be wrought out by economic thinking upon economic experience, and not by the historic political method. We stumble for the present because we are undertaking to solve economic difficulties in a political way.

I pause to say that we must at any rate abandon that procedure, and the sooner the better; that we must temporize as little as possible with immediate consequences, and found our hopes upon a just regard for the long-time fruition. We ought not confuse emergency remedies with long-time readjustment. We should proceed without delay into the inevitable transition from artificial stimulants to the substantial and approved American process.

The American system of free enterprise and the American form of government are parts of one whole. Neither can exist without the other. They are the product of natural aspiration for liberty, of ordered liberty, and the special experience of the English-speaking people which produced the common law, the soul of ordered liberty, and of the method of evolving law out of experience—of finding the weakness in any aspect of the law, of identifying the mischief and applying the appropriate remedy consistent with the standards of the system. To the English experience our colonial experience added much, but it did not alter the process. We avoid the arbitrary, we cultivate the judicial. We conceive of government in civil matters more as umpire than as administrator. We abhor government by decree. We go just far enough to find and apply our remedies, try them, and improve them as necessity demands.

It is conceivable that, with our attachment to the political rather than the economic, under pressure of special conditions and from special groups, we have lately been going too fast and too far from our accepted modes of government and of industry, and that the cessation of the flow of capital and of the expansion of enterprise is the immediate consequence. It is also conceivable that unless we correct our course, the ultimate consequence will be the breakdown and overthrow of the system. It will not withstand the strain of strict and vast centralization and regimentation, on the one hand, and it cannot survive its own failure to meet the aspirations of the people, on the other.

In this view our present circumstances present the first grave challenge to our constitutional democratic processes in our history.

I conceive that our only course is to build upon our historic structure, to preserve its form and its essential spirit, and, if we must alter, that we shall do so in the mode of the development of the common law evolution, the method of patience, applying Burke's standard of a due regard for the past with a capacity to improve, in the true liberal tradition.

So one may well say that the preservation and fair operation of our American system of constitutional representative democracy is a primary essential for permanent recovery. We cannot recover without it. We must seek recovery with it.

Our problems have heretofore seemed to be political rather than economic. The general economy in the new land could take care of itself, notwithstanding the blunders of politicians. But this happy situation lies behind us. Those blunders now are serious, and may no longer be afforded. Our federal experience in administrative law and regulation is new and brief. It is not surprising that we make blunders. It is rather gratifying that our blunders have not been more harmful. We need experts in the Congress, if not as members, at least as advisers to the committees. We must learn to think economically as well as politically. Tax laws must be framed, for example, more with the view to economic consequences than to revenue. We have now many advisers on revenue but none on economic implications.

Nevertheless, it is not to be assumed that the problem of permanent recovery, as I have defined it, is wholly one of government. It is rather one of general policy, public and personal, upon which legislation and administration have important bearing, in which politics may help or hinder, and which is dependent even more upon what government may not do than upon what government may do.

At the present moment no small degree of our difficulty lies in too much concern on the part of the government in economic affairs, and too much dependence of population and industry upon government. The chief factor in recovery is the people, and the unit of the people is one person. Right now he needs more of that freedom of action, that self-reliance, and that incentive to achieve which erected the situation to which we would return. Here are moral and spiritual factors to be recovered. And here the political ought to withdraw all save the necessary restraints of an orderly society.

The soul of that astonishing progress in the United States, which gave us our unrivaled standard of living, lies in the word "incentive". Men here knew that labor would have its reward, that excellence would bring one to the top, that honorable dealing, frugality and self-discipline would put one ahead, that nothing less would serve, and that none could take away the fruits of diligence in endeavor. They knew that their enterprise would have full fair play. It is essential to permanent recovery that this incentive shall not be impaired.

Our great bulwarks of due process of law, of equal protection of the laws, of government responsible to the governed, of a government of laws and not of men, of independent tribunals of justice, and of local self-government—of governing powers restrained by a great charter—have been guarantees upon which every man could and did rely to protect him in his person and his possessions. In them lay security.

This singular appeal to the spirit of men accounts for our progress. It suffused the population with a vigor in well-doing that would have been, and always will be, impossible otherwise, that could not be approached in lands where the

rule was once a peasant always a peasant, once a chambermaid always a chambermaid, or where, in more modern organizations of government, the population works solely for daily bread.

It is, therefore, essential to permanent recovery that we abandon any policy that tends to impair this incentive, and that we adopt every possible policy reasonably calculated to encourage it.

I am not unaware that we enjoyed the boon of a new and favored land, and the structures of a vast civilization to build. These added to that incentive and, of course, they account for a measure of that progress. It must be recognized that it is not likely that we are hereafter to build so much or rebuild so rapidly. One of our problems is to adjust to an altered national tempo in an altered and disturbed world.

Our present question is: How far can we afford by the political method to adopt measures that tend to impair that incentive? How far shall we trust law and administration?

Men are afraid now to invest or expand. The characteristic of the depression since 1930 has been the cessation of the flow of capital into enterprise. At the beginning this was due to losses and to shock attendant upon the collapse of the credit inflation period. It was more normal than abnormal. But why has it persisted? Why does it persist? We have been recovering from depressions every few years for more than a century—recovering by way of the assertion of that incentive of which I have been speaking. Why does it now delay its normal operation?

Some excellent things to break the force of the collapse, and to put the population in position to start over, have been done. We provided loans for industrial and commercial institutions, we rehabilitated the entire banking structure, we restored to them immense funds of comparatively liquid assets, we built up an immense gold reserve, we refinanced and saved the mortgaged farm owners and home owners, we have undertaken to break down foreign trade barriers, we have taken reasonable care of the unemployed, we have brought about lower interest rates and lower power rates, we have gotten rid of certain unsound financial structures. We have suppressed certain bad practices. One may note that the corporations are reporting good earnings for 1937, that retail sales were quite satisfactory until very recently, and that there has been extensive and beneficial refinancing throughout the country. For these achievements due praise to the President.

But capital does not flow into enterprise; there is but little expansion. Meantime 500,000 additional new workers have appeared each year, and recently the number of the unemployed has risen by approximately three million, while on every hand there is depression and a fresh access of doubt. We have not recovered. We are in better position to recover. But why do we not proceed?

May we not inquire whether, while doing these excellent things, which otherwise would have been sufficient to set us well on the road to genuine recovery, we have done other things which have tended to extinguish that incentive without which the men and women of our land will never strike their accustomed stride? May we not suspect that in our zeal we forgot that after all there can be no permanent recovery without the steady flow of capital and workers into enterprise? That we have confused emergency measures with normal operations? That in inviting the artificial we have repressed the natural?

What was the effect of the capital gains tax, enacted in 1932, which prohibited the offsetting of capital losses save against capital gains plus $2,000? Couple this with the higher income taxes. The investor was informed that if he made capital gains, the government would take a large share of his gains. But if he should lose, so far as his ordinary income was concerned, he would be taxed upon it as if it were net income. Men will not be inclined to invest money upon such terms. It is essential to recovery that this sort of taxation be abandoned. It was never intended that our citizens should be taxed save upon net income, i. e., ability to pay. A capital gains tax ought to look to the turnover of investment more than to revenue.

What shall be said of the tax on undistributed profits, the obvious effect, if not the deliberate purpose, of which was to put a penalty upon the application of earnings to payment of capital loans or to expansion of a business? It impaired credit, it repressed enterprise, and it tended to destroy faith

in the good sense and the good will of the government. It was never intended that the taxing power should be employed to regulate management or credit. It is essential that this sort of legislation shall be abandoned.

What shall be said of various undertakings—loans and works—that had all the appearance of a program of government competition with private enterprise? Men will not expose their savings to a competition that in its very nature is ruinous. We need here now emphatic assurance. If there is a field which the government intends to take over, it must be marked off at once. And if beginnings now made are precedents, who can give assurance?

It is essential to permanent recovery—essential to the flow of private funds—that all men know what is intended to be done with public funds. Men may well invite necessary regulatory laws under the equal protection and due process standards; men may bear great burdens of taxation, but their enterprises cannot survive regulation, taxation and government competition. To invest savings under such circumstances is to throw them away. It is essential, therefore, that the policy of government competition with private enterprise be abandoned.

Again, we have this matter of an unbalanced federal budget. We are all agreed that it ought to be balanced, and we talk much about it, but what are we doing about it? And what are the consequences of this prolonged state of unbalance—of deficit financing, and of ever mounting public debt? For eight years in succession federal expenditures have exceeded receipts by from a billion to three billions a year. The national debt has increased by more than $20,000,000,000. What is the effect? Taxes, present and future, are uncertain. Currency values are uncertain. The entire price structure is uncertain. Every investment, whether in bank deposits, insurance policies, loans or stock purchases, is uncertain.

We cannot expect capital to flow normally under such conditions. It requires at least a fair degree of stability. Men do not know where to put their savings, and they wonder what may become of past savings. They are induced to hoard rather than to earn. Here is a grave undermining of the national faith; it goes on gradually, but its culmination cannot be doubted unless the process shall be arrested and reversed.

Nor may we longer depend upon promises and prospects. We must do two things—reduce spending, whatever the consequence, and increase revenue. It is out of the question to balance the budget within a year. But we ought to be doing enough of both to give firm assurance in every quarter.

Of what value are relief and other public spending, if they lead to ruin under circumstances that might predicate revolution—a general prostration and a bankrupt treasury?

So write a balanced budget down as essential to permanent recovery—indeed, as essential to the prevention of ruin.

Say what you may for the humanity of spending, its final phase is far from humane. Spending that destroys stability and represses investment destroys all means of reëmployment in enterprise.

Industry, for all its stimulation, had a discouraging year in 1937. Demand quickened, profits appeared, but the principal effect was a labor war of great magnitude. Industry reëmployed in 1936-37 about 6,000,000 workers, but it did not expand. In the last quarter it collapsed.

The act of Congress known as the Labor Relations Act provided not only for collective bargaining, quite desirable in itself, but also for the weapons of a vicious warfare. A wedge was driven between employer and employee, and federal agents marshaled the forces of discontent. There were elections, and election agitators, but owners and managers were under the duress of law to be silent. Strikers took possession of plants, and the governments acquiesced. A cabinet officer declared that the legality of this common law trespass with force and arms had not been determined. The mails were stopped and the Post Office Department surrendered. It would be neutral! In other words, government in the United States in 1937 ceased to govern.

Is it necessary to say that it is a fundamental essential for any sort of recovery that our governments, state and national, shall govern; that this must be a government of laws equally, invariably and promptly enforced? We abandoned the confederation because it could not govern; and we established this Federal Union in order that there should be government. Men

who invoke the law ought to be lawful. A government that succors its people must also govern them.

Capital will not flow, if the property into which it would flow may be occupied by men who will neither work nor suffer others to work. Nor will men invest savings, if others may take charge of their investments and manage them. For this reason government is quite as important to workers as to investors. There must be order in the United States before there can be justice or opportunity. What encouragement is there now to revive and expand if such a course as we had in 1937 shall be renewed?

It did not add to anyone's satisfaction in the premises that the leader of the sit-down strikers was responsible for half a million dollars in political campaign contributions and in the midst of the strikes referred significantly and insolently to the fact.

No one can object to an act providing for collective bargaining, but, to be a good rule, it must work both ways. If it restrains one side, it must restrain the other. If it binds one side, it must bind the other. If it prevents coercion on one side, it must prevent coercion on the other. No group of men in America ought to have power under color of law to compel any man either to join or not to join them. In such matters the government cannot be a partisan. If owners may not exclude a worker on account of his organized affiliation, organized workers ought not to have power to exclude him because he chooses to have none. Freedom must be freedom or surrender altogether. A just law as between management and workers is, therefore, another essential of recovery.

Much may be said for a balanced program of production, and the restriction of money crops in the interest of a sound farm economy. A great deal may be said in behalf of a national policy of conserving the soil and other natural resources, of flood control and reforestation. But a policy of reducing the production of annual wealth cannot be defended. If we are to have a materialistic realization of the spiritual phrases, "the more abundant life" and "green pastures", we must "replenish the earth and subdue it". If we would lift one third of the population to levels of well-being, if we would increase the federal revenue, if we would balance the budget, if we would reduce the number of the unemployed, if we would increase the national income, if we would provide for those who are unable to produce, there is but one way and that is to produce more of annual wealth—more from the sea, the land and the bowels of the earth—produce it, transform it and see to its distribution. The encouragement of endeavor to increase production of annual wealth is another essential of permanent recovery.

Let us not confuse money with wealth, or price with wealth. The time will never come when a government may so contrive that one bushel of wheat will contain more of wealth than two, or that one bale of cotton will add more real income to the people than two, or that five hours' work will produce more wealth than seven. There is no substitute for work—and government is the poorest possible pretext of a substitute.

If we are to pay bounties they ought to be paid to induce production, not to repress it, to conserve the soil in order to produce a balanced agriculture of abundance, not to induce scarcity. There is no reason whatever for compulsion in the premises. It predicates too much for prudent men to stand for.

My point, in this review of current policies, is that if we would maintain our American system, if we would prevent that failure which would predicate another and a worse system, we must give it a chance. We must encourage and exercise that system, we must so exercise it as to provide incentive to American investors. I am well aware that there are those ready to say that artificial measures and drastic regulations were resorted to because that system had failed; that under no circumstances would incentive have operated. But the answer here is that we cannot be sure of this until we shall have tried it out, and we have not tried it out. Surely we will not, because of a great collapse throughout the world, proceed to abandon a system, that worked better here than in any other country for a century and a half, for systems that promise nothing in relative welfare and far less in the moral and spiritual values, without a determined effort to readjust and to preserve it.

Finally, there is a general suspicion, I hope not well founded, that in spite of all we may do our present system may fail;

even that public policy may come too late, or mistakenly, to its aid, in which event the fate that has overtaken other countries may overtake ours. It is reasonable to argue that the probable alternative to our system of constitutional representative government would be some form of authoritarianism, some type of collectivist society or totalitarian state. This fear also arrests the flow of capital, of industry, of commerce and of employment. It is essential to permanent recovery that we take every step necessary to allay it.

It seems to me that once the American people realize what such an alteration would entail, not only in the loss of spiritual and moral values of infinite import, but in poverty, suffering and cruelty, there will be no danger here. Grant every argument that may be made against our system, our state would be infinitely worse under any other. We would lose the priceless element of vigor that has brought us thus far, we would abandon the American incentive, and sink at once to a daily bread existence under the taskmaster's orders. For all that we have achieved, we would take in exchange the feeble activities of unrewarded endeavor; we would indeed discover that we had in a passing hour of distress exchanged the birthright of a lifetime for a mess of pottage.

Our American system will not fail. Our people will preserve constitutional representative democracy, and preserving it will preserve themselves and their destiny. It is established in the character of their civilization and in their cherished traditions. We will pay the price, whatever it may be. We will endure the ordeal, whatever its conditions. Have faith in the United States of America, in the constitutional representative democratic process, described by the fathers as the new order, not of a day, but of the ages—the order of that liberalism which derives from liberty of men as opposed to the power of authority. Have faith in the common sense and the character of the American people.

The people of this country have come up out of severe depressions again and again, and have been the better for the experience. More than once have they approached the edge of the precipice of ruin, and turned back, adopted sane counsels, rebuilt and enlarged. They have preserved their system and it has provided them with the sure solution of their difficulties. It will not fail them now, nor will they abandon it. They will find the way to correct its weaknesses, and proceed.

In 1824 Henry Clay drew a description of the then existing depressions in terms which I might here read as perfectly fitting the present circumstances. In 1837 eminent men publicly despaired of the preservation of the Republic. There were dark years in the sixties. As recently as 1893 our foundations appeared to be sinking under us, and all the Jeremiahs had great liberty. How brilliantly have we triumphed again and again!

Some of us recall in personal memory the prostration of the people of the Southern States for three decades. When Lee surrendered, money did not exist within their borders, and all supplies were reduced to a minimum. But the Southern people with naught save the good earth and an invincible spirit recovered, and at this hour their region is the least depressed portion of our country. They paid the price in self-discipline, in simple living, in hard work and a protracted thrift and frugality. That system of free government and that incentive to high endeavor, which are the characteristics of our Republic, enabled them to overcome every consequence of unspeakable calamity.

If England may in her dark hours appeal to her history,

> All our past proclaims our future,
> Shakespeare's voice and Nelson's hand,
> Milton's faith and Wordsworth's trust,
> In this our chosen and chainless land—
> Come the world against us, England yet shall stand!

We may do no less. For ours is a story not of constant rise, but of difficulties and of triumphs.

There is naught for Americans to do but to press on, and, when that seems impossible, naught but to endure, to preserve and to survive. Readjustment will entail hardship; rebuilding will demand sacrifice; to carry on will require courage, but we cannot confess that we or our fellows are unequal to our tasks, or to the moral test of our times. Nor may we say that our circumstances are, at worst, less favorable than were the circumstances of those who have preceded us, and from whom we received our heritage and the inspiration of their examples.

We have all to lose and naught to gain in any other course, and with our loss would go also a shameful realization that we were unworthy to preserve the most precious inheritance ever handed down to a generation of mankind—our favored land, our representative constitutional democracy, our free spirit, our fair opportunity to burgeon forth all of which we are capable.

Twenty centuries ago a broken man, leading with all the world against him the desperate cause of a persecuted order, reviewed and interpreted three thousand years of his people's struggles and victories in terms of faith, not as a religious exercise, but as the spring of national progress and personal triumph. He summed it up in such words as these:

"Through faith they subdued Kingdoms, wrought righteousness, obtained promises, stopped the mouths of lions, quenched the power of fire, escaped the edge of the sword, from weakness were made strong, waxed mighty in war, turned to flight armies of aliens!"

One does not fail as he lingers by the Pilgrim Monument at Plymouth to observe that upon its towering shaft stands the symbol of Faith, nor does one fail, looking back more than three centuries to the event it commemorates and all that followed, to comprehend somewhat of its significance. Much do we need now to do and endure. More is essential than I have been able to detail. But above all the principal essential of permanent recovery is the recapture of Faith—in ourselves, in our fellow Americans, in the ministers of our government, in our constitutional democracy, and in our fathers' God.

PART III

THE PREREQUISITES OF RISING STANDARDS OF LIVING

INTRODUCTION *

WESLEY C. MITCHELL, *Presiding*
Professor of Economics, Columbia University
Director, National Bureau of Economic Research
President of The Academy of Political Science

YOU will observe that the program of this Fifty-Eighth Semi-Annual Meeting of the Academy of Political Science is all of one piece. At the morning session we had several excellent discussions of the " Impact of Reform on Recovery ". At the luncheon meeting, which Dr. Williams and I left prematurely in order to open this session at the time announced, they are discussing what Mr. Richberg called the " Essential Essentials for Sustained Recovery ".

This afternoon we are dealing with the closely related topic, " The Prerequisites of Rising Standards of Living ". It is clear, of course, that the real meaning of recovery from the viewpoint of the country as a whole is an improvement in the standard of living for the mass of the population.

The first paper this afternoon is to be presented by a distinguished economist, one of our wisest authorities on banking, a man of such versatility that he has been recently appointed the head of a new institution which aims to prepare men for all branches of the public service.

I have much pleasure in introducing Dean John H. Williams, of the Graduate School of Public Administration of Harvard University. Dean Williams!

* Opening of the Third Session of the Semi-Annual Meeting.

THE FORMATION AND USE OF CAPITAL

JOHN H. WILLIAMS
Dean of the Graduate School of Public Administration, Harvard University,
Vice President of the Federal Reserve Bank of New York

MY topic this afternoon is " The Formation and Use of Capital ". We think of capital formation primarily in two connections, the business cycle and long-run economic progress. From these two points of view, capital formation presents something of a paradox. It is at once the hero and villain of our economic drama. We have come to look upon capital formation as essential to economic progress and to regard the business cycle, which is primarily a cycle of investment, as the price that we have had to pay for progress through capital formation. Not that we are content to pay this price in so far as we can learn to avoid it, but we have thought of our capitalistic system as one that has demonstrated its powers of growth, one that has resulted in increased real income, increased productivity per worker, primarily by reason of the application of capital to economic effort; and at the same time we have come to look upon the cyclical fluctuations of capital investment as a great unstabilizing force in our economy.

I am not going to speak this afternoon about the business-cycle aspect of capital formation, but about the long-run aspect, its relation to economic progress. That there has been such a relation in the past seems obvious. The whole history of modern capitalism can be brought forward in proof. In no other way could we have sustained the great increase in population that has occurred in the last two hundred years or so. We think of the Industrial Revolution, the expansion of the railway net, the age of steam, the age of electricity, the age of the automobile as all having been made possible through the accumulation and application of capital.

I want to dwell particularly this afternoon on the growing opinion—or possibly we should say the growing fear—that our period of economic progress may be drawing to a close. The fact that we have now had two depressions in a row, the last one the greatest depression in history, and this one already a major depression in that it has gone beyond what we ordinarily think of as the limits of a minor depression—those facts have raised in the minds of many people the fear that the period of progress, the period of capital accumulation, of finding always new ways of applying capital in order to improve economic welfare, may be drawing to a close. That, it seems to me, is the central thesis of Keynes' last book.[1] That is what underlies a good deal of current investigation of the relation between saving and investment, and the tendency to conclude that there is danger of chronic over-saving or under-investment.

We are told, in other words, that this recurrence of depression may well mean that there is now a bias in favor of economic contraction, that we may have to find out how to live in a contracting economy, or to find some satisfactory alternative for private investment. This is not a new belief. One finds expressions of this kind all through the nineteenth century. Macaulay said in the eighteen-thirties that there seems to be something in human nature which prevents our believing that the next generation can make as much progress as the last. That is particularly true if we, in our generation, have been living through a period of rapid progress.

In England in the thirties, in the " hungry forties ", through the fifties, there was a great deal of talk of this kind, and in our own country during the period of the long depressions and the short recoveries—the seventies, the eighties and the nineties —there were similar expressions of this fear. One of the best known is that of Labor Commissioner Wright in the eighties. He pointed out that in all the industrialized countries there was a growing question as to whether we could find the means of applying new saving. Europe had expanded throughout the world, the frontier was disappearing, the railway nets had been pretty well completed, and it was difficult to foresee how we were to find the means of further progress on a comparable scale.

[1] J. M. Keynes, *The General Theory of Employment, Interest and Money* (New York, 1936).

Again, immediately after the War, fears were expressed by many economists that the world had during the War developed an over-capacity for production and might be in for a prolonged period of retrenchment; and now, again, under circumstances of severe and prolonged depression, there has been a recurrence of these fears. How much truth may there be in this view? More fundamentally, how essential is the continuance of capital accumulation to economic well-being? Those are the two questions I want to deal with.

The view that capital accumulation may be coming to an end and bringing with it the end of an era of progress, presenting us with the quite different problems of a contracting economy, seems to me to rest principally on three grounds. One ground is that there is inherent in the capitalistic system a tendency toward underconsumption or overproduction, two names for the same thing. This view has interested economists through all the decades since the early nineteenth century. One of the first expressions of it was that by Sismondi, the Swiss economist, in 1819. We find it again in the writings of Karl Marx, who tells us that capitalism inevitably digs its own grave. We find it again in the social credit theories of the post-war period. In each case it turns essentially on the thought that the reinvestment of profit takes away from the consumer the purchasing power which is necessary to take goods off the market without loss to the producer. As Foster and Catchings expressed it, in what they called their dilemma of thrift, the result of the capitalistic system with its reinvestment of profit and saving is that purchasing power goes twice into production for once into consumption. Karl Marx put it on the ground that profits represent exploitation of the worker, that the worker does not get the value of his product and therefore cannot consume it, and hence there is under capitalism an inevitable growing tendency toward chronic depression.

We have seen expressions of this thesis in recent years in our own governmental policy. The N.R.A. was based in part upon the idea that there is a tendency toward deficiency of buying power on the part of the masses of the population, and that the way to get recovery is to raise wages in order to increase purchasing power. We have had many expressions of it since the N.R.A. was discarded, particularly in connection with the discussions of the undistributed profits tax and the wages and hours bill. It is a very persistent idea.

This view, that there is in the capitalistic system as it has hitherto functioned a persistent tendency toward underconsumption, has both cyclical and secular aspects. With the cyclical aspects I cannot deal. Though in some forms of statement it has a certain plausibility, which Hayek's work has not satisfactorily removed, I have never thought it a very convincing major explanation of the business cycle. As an explanation of what has happened in a secular sense, it has seemed to me totally unconvincing because it flies in the face of history. During the past century and more in which this complaint has been made, we have actually been making more economic progress than at any other time in the history of the world.

A second explanation, and one that appeals to many economists who discard the first, is that there are technological reasons for expecting a declining rate of growth of capital or even a cessation of growth. There is no law which compels steady continuing progress, and economic history does not show such progress. We have progressed by jerks through periods of time that are longer than a business cycle and which some economists call the long waves. The Industrial Revolution in England was followed by recurring periods of unsettlement and even of stagnation. Colin Clark describes the economic condition of the English workman in the middle of the nineteenth century as being truly deplorable. Similarly, the railway expansion, as it passed from country to country, provided no regularity, much less permanency, of progress, and terminated in such periods of stagnation as in the seventies and the nineties. Then came the burst of large-scale business organization and the age of the automobile and electricity, and, in the midst of it, the period of the World War. As we look back at this period from the present decade with its long depression, which is now renewed, we face again the question whether, and by what means, economic progress can be resumed.

As I say, this argument rests largely on technological grounds. It rests also on the disappearance of the frontier. We are told that for a long time the world could rely on pushing out the frontier from the European industrial center, and

so long as there remained a world frontier there was always a tendency in favor of renewal of development even though it might be interrupted from time to time. Now, as we are told, the frontier is gone. At any rate, it is gone in this country, and our experiences of the twenties with international investment have not left us in the mood to attempt to develop whatever frontiers may remain elsewhere.

This thesis presents a number of difficult aspects. It is far from proved that if world trade barriers, which have been greatly multiplied by the War and the depression, could be removed, there would not still be room for substantial progress through exploitation of the world's resources. The economically well-developed portion of the world is still geographically the minor part. The area of high real income is not very extensive, and even within this area the income is not really high for any but a minor part of the population. The present stagnation of international investment need not be taken as necessarily a permanent condition. The nineteenth century presents a number of parallels for our present discouragement in this regard, each coming after a period of excessively rapid or otherwise unwise international investment, but proving to be only a temporary interruption of a continuing development. Whether the world will have sense enough, and will find the means, to remove the barriers to international economic intercourse is one of the largest economic questions of our times.

But in any case, we ought not to exaggerate the importance of the frontier. The history of international trade indicates that trade has been greatest among the industrialized, capitalistically developed countries themselves, and not between such countries and the young countries, which constituted the frontier. Life on the frontier is after all fairly primitive and the main hope for increased production and consumption may lie within the areas which already have higher standards of living and greater technical resourcefulness.

But an even more fundamental question is how essential the continuance of capital accumulation really is for the continuance of economic progress. I have been very much interested by the work recently done by Kuznets in this country and by Colin Clark in England on the relation of capital formation to the national income. The experience of England since the War seems especially significant. I confess to being one of those who during the twenties were inclined to take a dark view of England's future. Here was a small country primarily dependent upon international trade, which had been seriously impaired by the War and the wave of nationalism which followed it. Primarily for this reason, we thought of England as being in a state of semi-chronic depression from which there appeared to be little hope of escape. We talked of the necessity of liquidating the British economy in some sense, by migration of labor and capital or acceptance of a lower standard of living. How could England hope to find domestic alternatives for her great international industries which were declining?

Yet, since 1924, according to Colin Clark, England has made more progress in terms of real income and of productivity per worker than in almost any other period of her history. This small country, whose territory is no greater than that of some of our largest states, supporting a population one-third that of ours, now has a national income about half as large as ours. So long as such comparisons are possible we seem hardly justified in taking a gloomy view of our own potentialities of progress.

How has England's progress been accomplished in the face of such apparently strong grounds for pessimism? Progress has been made in two cycle periods, 1924-30 and 1931-36, the dividing point representing the impact of the world depression. In the second period, the improvement in the terms of international trade following England's departure from gold, which resulted in cheap imports, was an important influence, and even in 1924-29, contrary to much current opinion, the terms of trade appear to have been more favorable to England than in the immediate pre-war period. This may well be a special circumstance in England's case which cannot be generalized, since the "terms of trade" are relative and not all countries could expect improvement in these terms concurrently.

Another circumstance which Clark mentions, and which may strike some of us as more startling, is a "very considerable rise in general standards of consumption, among the rich through

the cessation of saving"[2] (and the poor through cheap imports). In his analysis of saving he finds that the important categories are undistributed profits, working and middle class savings (mainly through building societies and life insurance), and state and local authority savings. Even more surprising, perhaps, are his figures of net investment as a percentage of national income, which were 12.2 per cent in 1907, 8.1 per cent in 1924, 7.2 per cent in 1929, and 6.9 per cent in 1935.[3] To sum this up baldly, it seems to tell us that the progressing economic society is that in which (a) the rich no longer save, and (b) the proportion of national income which is saved and invested steadily diminishes. Clark sums up his own findings by stating that "I believe the facts have destroyed the view up till now generally prevalent, that the rate of economic growth was primarily dependent upon the rate at which capital could be accumulated. The very rapid expansion in productivity at the present time is taking place at a time of heavily diminishing capital accumulation. What is more remarkable, practically none of the capital which is being saved is being put into productive industry proper."[4]

These are surely very arresting statements. In the light of previously accepted economic doctrine, they sound at first like something from Alice in Wonderland. Yet they are the product not of social philosophy or of abstract economic theory but of the soberest kind of statistical work; and on reflection they are perhaps less paradoxical than at first they seem. The statement that in England the rich no longer save appears to mean in part that saving and investment are becoming increasingly institutionalized. The fact that investment has become a smaller fraction of national income may not be altogether irreconcilable with the orthodox view, which has held that capital accumulation is essential to economic progress. The two statements may well relate to different stages or phases of economic progress. In the earlier stages of economic development the emphasis is upon the rate of growth of new capital, but in proportion as the society becomes more capitalistic the emphasis may well shift to the replacement and improvement of existing

[2] Colin Clark, *National Income and Outlay*, p. 270.
[3] *Ibid.*, p. 185.
[4] *Ibid.*, p. 272.

capital equipment. This appears to be Colin Clark's own conclusion. He stresses the "improvement of our technical knowledge, and what is equally important from the viewpoint of the national productivity, the growing up of a generation of trained and experienced workers and technicians who can apply this knowledge." Given this knowledge and the ability to use it, he concludes that "without new investment the replacement of obsolete capital . . . appears to give all the necessary scope for the introduction of technical and organizational improvements, and to bring about the rapid increase in productivity under which we are now living."[5]

That this is a phase of change from an earlier to a later phase of capitalism, as I have suggested, appears to be borne out by Clark's estimates, and also those of Paul Douglas which he cites, of yearly additions to British home capital since the eighteen-sixties. Clark introduces them with the remark that "this [the decline of new investment] is no more than the continuation of a process which has been going on for generations." Capital accumulation was most rapid in the eighteen-sixties, which was also the period in which real income rose most rapidly. The absolute yearly additions to home capital reached their maximum in 1875, and have declined not only relatively but absolutely since that time. What conclusion to draw from these figures is rendered somewhat uncertain, at least for the pre-war period, by the fact that he offers no comparable estimates for international investment. From the standpoint of the British economy as a whole, and the effects of capital accumulation on it, neither category of investment would by itself tell the whole story, and neither could validly be excluded, and at some periods much more of British capital was invested abroad than at home. But in the post-war period, and particularly since 1930, the decline has been in both home and overseas investment. Yet it has not prevented a marked increase in per capita real income.

Some significant changes in capital formation in our own country and its relation to national income appear to be indicated by Simon Kuznets' study, recently published,[6] of *National Income and Capital Formation, 1919-1935*. For this period he finds that of the average yearly volume of gross capital formation in the United States, 62 per cent in current prices and 68 per cent in 1929 prices represents capital consumption (replacement) and only 38 and 32 per cent, respectively, net addition to the stock of capital goods.[7] Leaving out public agencies, in order to get a measure of private capital formation, the comparison is even more striking. His figures show that of gross private capital formation, 81 per cent is accounted for by capital replacement and only 19 per cent by net capital formation.[8] These figures again suggest that our problem of economic progress has become mainly one of replacement of capital and of taking advantage of opportunities to improve the capital we replace and the technical efficiency with which we use it. From this point of view, an increase of the obsolescence rate might well be of greater importance in determining real income and productivity per worker than the search for new outlets for further capital development. And one should add, of course, that it is by no means certain that such new outlets will not be found.

Two other findings in Kuznets' figures deserve special mention. The first is the importance of residential construction in capital formation.[9] For the period studied it constituted 24 per cent of the yearly gross capital formation (1929 prices) and 11 per cent of the net addition to capital. Where to draw the line between investment and consumption is a difficult question, which we need not attempt to answer here (it would probably be different for different analytical purposes), but one important change which appears to be taking place in the modern economy is an increase in spending upon durable consumer goods, including not only houses but automobiles and many other products, as compared with producer goods; and here again, as the volume of such goods grows, it is the replacement (and improvement), rather than the further increase of volume, which will assume increasing significance.

[5] *Ibid.*, p. 272.

[6] National Bureau of Economic Research, New York, 1937.

[7] P. 49, and table 14.

[8] Including business, residential construction, and net change in claims against foreign countries.

[9] Kuznets, *op. cit.*, tables 13 and 14.

The other significant fact shown by Kuznets' figures is the importance of public agencies in capital formation. For the period covered, 1919-35, public agencies accounted for 24 per cent of gross capital formation and 49 per cent of the net increase in our stock of capital goods. These are striking figures, particularly the share of government in new capital formation. That this share is so large is due in part, of course, to the increased activities of government growing out of the depression and the conscious use of public spending and investment as a means to recovery. But the figures of the twenties[10] show that even then, under conditions of prosperity, government agencies accounted for about one fourth of net capital formation. One conclusion that has been drawn by economists who are fearful of a secular tendency toward declining private investment is that public investment must take its place. These figures indicate the importance which public investment has already assumed in our economy.

The reference to public investment brings us to the third reason which is advanced for expecting a slower rate of economic progress in the future than in the past, the relations of government to private enterprise. There are many who believe that we have come to a critical stage in these relations, in that we have developed a hybrid system, which is neither free enterprise nor collectivism, but such a combination of the two as gives neither a proper opportunity to function effectively. The result, it is felt, is likely to be an impasse, from which there can be no escape until it has been resolved by a much clearer indication than we have yet had of which course we mean to follow.

The history of governmental intervention did not, of course, begin yesterday. Indeed it is doubtful whether we have ever had a system that could truly be called laissez faire. But undoubtedly, under the conditions of the post-war world, we have been having intervention on a larger scale and in different ways from those to which we had become accustomed; and that has been true not only of countries such as Germany or Russia, where free enterprise has been entirely supplanted by a planned economy, but also, in much less degree, in countries like our

[10] *Ibid.*, table 13.

own, where governmental intervention has been forced by the great economic emergency of the depression. It was inevitable that this pressure for governmental intervention should take the form of demand not only for emergency recovery measures, but also for reforms and measures of social amelioration, some of which were overdue. It is a great misfortune from a technical point of view that the pressure for such measures should come under conditions which make it very difficult to institute them successfully, but that we must accept as a fact of democracy and of human nature. It would seem more intelligent, instead of storming against such intervention, to turn our minds to the difficult problem of directing it into constructive channels.

I am not convinced that in logic, at least, governmental intervention need mean the impairment of private initiative. It might well create the conditions under which private enterprise could operate successfully, in the interests of the whole community. But there may well be dangers of applying to the longer future conclusions which are valid only for the emergency, and of adopting measures in the emergency which may produce longer-run results which were not foreseen, or desired, in the beginning. It is in these connections that the disposition to take a gloomy view of the future of private capital formation might have special significance. There is at the present time, as a consequence of the renewal of the depression, a growing disposition to take sides as between a policy of removing obstacles to, and improving the conditions requisite for, private investment and a policy of renewed and enlarged public spending and investment. Into the merits of this question, strictly on grounds of recovery policy, I cannot enter. But one can readily see how the balance of emphasis as between two such approaches might be influenced by a pessimistic outlook regarding private capital formation, and how readily by such prejudgment we might find ourselves committed to measures which might bring about that very impairment of private enterprise which had been feared. Some economists point already to a progession of this kind in a chain which runs from deficit financing, intended to revive private investment, to increased taxation, which, both by its amount and by the forms that it has taken, has a tendency to impair investment and the incentive to invest. How correct this analysis may be I have not space to consider, but there would seem to be an obvious danger of driving capital away from private investment and into public investment by a combination of high surtax rates and tax-exempt securities; and I have become more and more inclined to think, as I have studied the problem, that the undistributed profits tax, and the capital gains tax in its present form, work in the same direction.

Perhaps here again, we can take a lesson from the English experience or that of the Scandinavian countries. In those countries also there has been a large and a growing participation by government in the economic life of the community and in the organization and direction of saving and investment, but, as Colin Clark's figures would seem to prove, such intervention has been effected in ways which have not impaired private initiative and the processes of private capital replacement and improvement to which he mainly ascribes England's post-war economic progress. In England, also, there is a heavy tax burden, probably exceeding ours, but with the important difference that it has accumulated more slowly, so that the process of adjustment has been more deliberate.

There is perhaps no need of a conclusion for this paper. Of the three grounds which I have discussed as constituting the main bases which have been cited as indicating a prospective decline of capital formation, and with it of economic progress under private capitalism, the last, the relations of government to private enterprise, seems to me to raise the most important, and the most immediately pressing, questions. The main point of this paper, I think, is that in dealing with these questions, the answers which I have attempted to give to the other two appear to me to have much relevance.

Remarks by the Chairman

Chairman Mitchell: Whether we can or cannot attain and maintain higher standards of living depends in notable degree upon the distribution of income and of wealth.

That dependence will be discussed by Dr. Morris A. Copeland who has long been a student of the distribution of income. In recent years he has had as good facilities for observation as can come to any economic statistician; for the Secretary of the Central Statistical Board in Washington not only is acquainted with the many-sided statistical work of the federal government, but also takes an active hand in planning new undertakings. In addition, Dr. Copeland is one of the most active and valuable members of the Income Conference associated with the National Bureau of Economic Research. With much pleasure I introduce him to the Academy.

THE DISTRIBUTION OF WEALTH AND INCOME

MORRIS A. COPELAND
Executive Secretary, Central Statistical Board, Washington, D. C.

IT is proposed to consider certain relationships between national wealth and income and business fluctuations which existing information illuminates. The national wealth may be conceived as consisting principally of the value of all tangible assets in the country at a given date: land and improvements, equipment and fixtures, and inventories. To this total should be added, since we are a creditor nation, the net equity of residents of the United States in property located abroad or the nation's net external credit. National income may be conceived in two principal ways for our present purpose: first, as the sum of all individual incomes such as payrolls, individual business profits, interest, and corporate cash dividends and additions to surplus; second, as the total value of goods and services consumed by ultimate consumers plus the net increase during the year in our national wealth. Measurements using these two definitions of national income should, if consistently made, yield identical totals.

Great progress has been made during the past twenty years both in the data available for measurements of our national wealth and income and in the techniques of constructing such measurements. Nonetheless we cannot push the question of the relationship of distribution of income to business cycles very far without recognizing that there are still major gaps in our information.

We know much more about the magnitude of the national income and its various distributions than we know about the magnitude of national wealth. Fortunately, distributions of national income are for many purposes more important than the distributions of national wealth. The personal distribution of wealth has come to be significant chiefly in two connections. (a) It is a basis for the concentration of industrial control, and

(b) it is part of a circle which makes inequality in the distribution of wealth and income self-perpetuating: concentration of wealth—hence concentration of property incomes—hence unequal distribution of total incomes; unequal distribution of total incomes—hence concentration of savings in the higher income brackets—hence concentration of wealth. In view of these considerations we shall devote our primary attention to distributions of income.

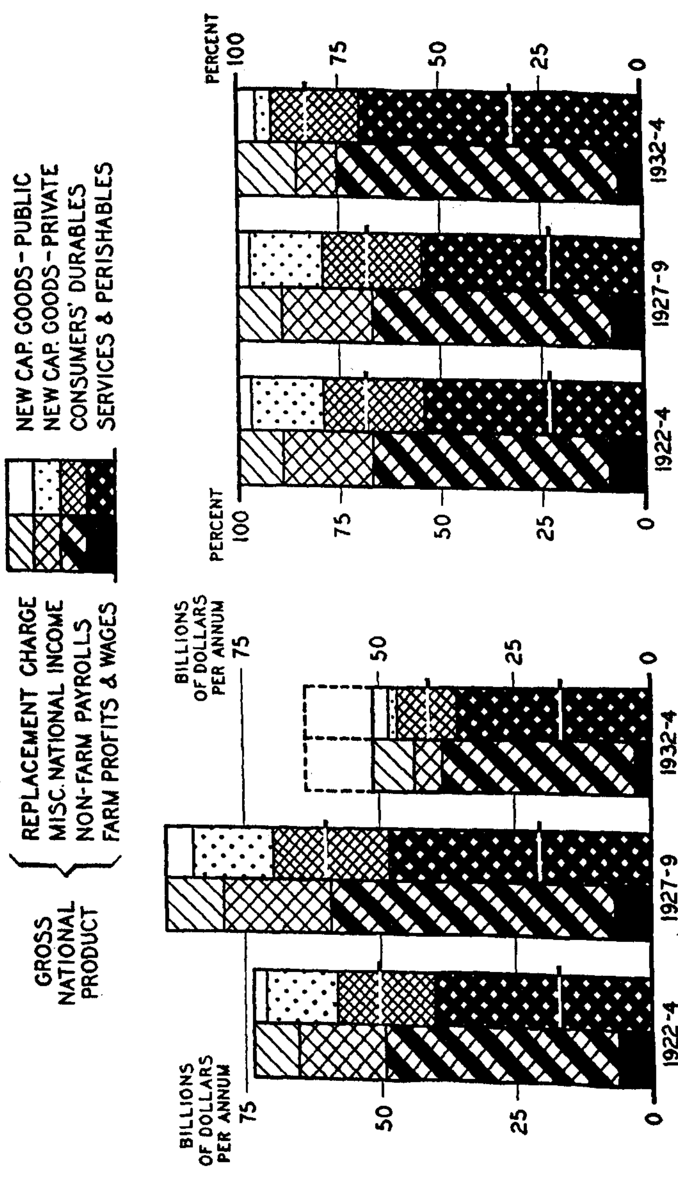
One very important step forward in our information about national income in recent years is the development of a concept, slightly more inclusive than national income, which has come to be known as the "gross national product". This concept is especially important for an understanding of business fluctuations. It has been suggested that the national income may be considered as the total value of consumed goods and services plus the increase in the national wealth produced during the year. The construction of a railroad car may represent either a net addition to the stock of railroad cars after replacements have been provided for or the replacement of a railroad car worn out in the period under consideration. The production of a freight car, when it is a replacement, and when it is an addition, is essentially the same; yet the addition is a part of the national income; the replacement is not. Gross national product includes all that the national income includes plus the volume of production needed to replace durable goods worn out and depleted during the year.

Our two concepts of national income may be paralleled by two concepts of the gross national product, each concept representing a different type of distribution. These two types of distribution are shown on a per annum basis for three selected periods on Chart 1. The data employed are based on a recent study of *National Income and Capital Formation* by Dr. Kuznets, of the National Bureau of Economic Research. The left hand bar for each period represents the various sources of funds used to pay for the goods and services shown in the right hand bar. Excluding the top section from this bar we have total national income; i.e., replacement cost must be added to total national income to get the gross national product. Two chief shares in the national income, that received by farmers and farm laborers and that

CHART I

DISTRIBUTIONS OF GROSS NATIONAL PRODUCT

BY OBJECTS AND BY SOURCES OF FUNDS



Source: Based on Estimates of Simon Kuznets, N. B. E. R.

The right-hand bars represent the annual output of goods and services in a roughly ascending scale of durability. In order, the various segments of the bar may be defined as follows:

1. Consumers' services and perishable goods. These are divided by a white line into
   a. Services to consumers, not embodied in commodities
   b. Production of perishable goods, normally used for less than six months
2. Production of consumers' durable goods. These are divided by a white line into
   a. Consumers' semi-durable goods, normally used for six months to three years, such as automobile tires, shoes, etc.
   b. Consumers' durable goods, normally in use for over three years, such as automobiles, furniture, etc. The value of residential construction has, however, been excluded here and put in the dotted section representing private new capital goods.
3. Private capital formation. This includes net changes in business inventories, but excludes changes in consumers' inventories. It includes new residences constructed and new durable goods acquired by businesses.
4. Public capital formation. This includes net additions to gold and silver stocks, but excludes changes in other publicly owned inventories. It includes new durable goods acquired by government.

received by all non-farm employees, are shown separately. These two broad types of income account for the major part of the income received by all but the wealthiest part of our population. They represent more than 70 per cent of total national income. The right hand bar of Chart 1 shows the various objects for which the national income, together with funds available for replacements, was spent in each period. The bottom portion of each right hand bar below the white line represents services which are consumed as they are produced and cannot be stored. As we go upward in the bar, we deal with longer-lived goods, until we come to the two top sections, which represent the total volume of new capital goods constructed plus the increase in business inventories. It will be observed that the part of the bar below these two top groups represents approximately consumed income, although this makes no allowance for changes in the stock of consumers' goods (other than dwellings, which are classed as capital goods). If we ignore changes in consumers' inventories, the difference between the height of the bar representing total national income at the left and consumed income at the right may be taken to represent saved income.

Unfortunately the measurements provided by Dr. Kuznets are not sufficiently precise to enable us to show distributions of the gross national product by separate years. We cannot, therefore, show relationships between a period of depression and a period of prosperity in the nineteen-twenties. Of the first two periods selected each includes a year of business recession. The second period shows a marked growth in the total gross national product, as compared with the first. The increase of 20 per cent compares with a population growth of 7 per cent. Prices were fairly similar in the two periods, so that no allowance for price changes need be made.

We cannot safely assume that the similarities between 1922-4 and 1927-9, although a marked business expansion took place, typify the process of shifting from business depression to business prosperity. The sharp decline in gross value product from 1927-9 to 1932-4, the three lowest depression years, is due partly to a decline in prices. What the gross value product of 1932-4 would have been without a change in prices is indicated approximately by the dotted line. The bars in the right hand chart show the same information as those at the left, but on a percentage distribution basis. There is a striking similarity between both the source-of-funds distribution and the objects distribution in the periods 1922-4 and 1927-9. The only change significant to the naked eye is a slight decline in the proportion of total income derived in the form of agricultural profits and wages. The 1932-4 distribution presents a marked contrast with the distributions in the other two periods. Replacement cost, being something of a fixed charge, has contracted less than other items and represents a larger proportion of the total gross value product. The farm income share has shrunk still further. Income from all sources other than farm profits and total payrolls, from which a large part of the income of the wealthy classes is drawn, has shrunk to 10 per cent of the total. In the objects distribution, consumers' perishable goods and services have come to represent 70 instead of 55 per cent of the total gross value product, while consumers' durable goods other than housing represent a slightly smaller share than in 1922-4 and 1927-9. Private new capital goods including dwellings represent only about 5 per cent of the total gross value product, a share now about equal to the expanded share of public new capital goods.

A satisfactory connection between the source-of-funds distribution of gross national product and the objects-of-expenditures distribution would involve more information about what is called the personal distribution of income (i.e., the distribution by income classes) than is now available. We know, however, that the bulk of the income of the middle and poorer classes is derived from payrolls and farm profits and that a large part of the income of the wealthier class comes from other shares of the national income. The wealthiest 10 per cent of the population receive very roughly about one third of the total money income. According to the Brookings study the poorest one third received in 1929 something like 10 per cent of the total money income. Such information as we have indicates a close relationship in the year-to-year variations between the income which takes the form of payrolls and farm profits on the one hand and the income of the poorest 90 per cent of our population (i.e., of all but the wealthiest 10 per cent). We know also that a large part of total saved income is

saved by the wealthier classes. We may expect to find, then, a rough relationship between payroll income and farmers' profits on the one hand and consumed income on the other. Consumed income was probably slightly less than would be indicated by the height of the two lower right-hand segments in 1922-4 and 1927-9 (Chart 1) because there is reason to think that consumers' stocks were accumulating during these years. Certainly this was true of automobiles. On the other hand, consumed income was probably a trifle greater in 1932-4 than the sum of the two lower right-hand segments would indicate because consumers' stocks were being depleted. With these qualifications in mind we may note that in each period consumed income is apparently appreciably larger than income from payrolls and farm profits. The excess in per cent of gross product was greater in the depression years 1932-4 than in either of the other periods. Indeed, consumption in this period actually exceeded the total national income. Corporate dividends paid out of surplus and individual capital withdrawals meant that depreciation and depletion allowances were not used to maintain the nation's stock of plant, equipment and inventories; that, in fact, the nation was living on its capital to the extent of some three billion dollars per annum.

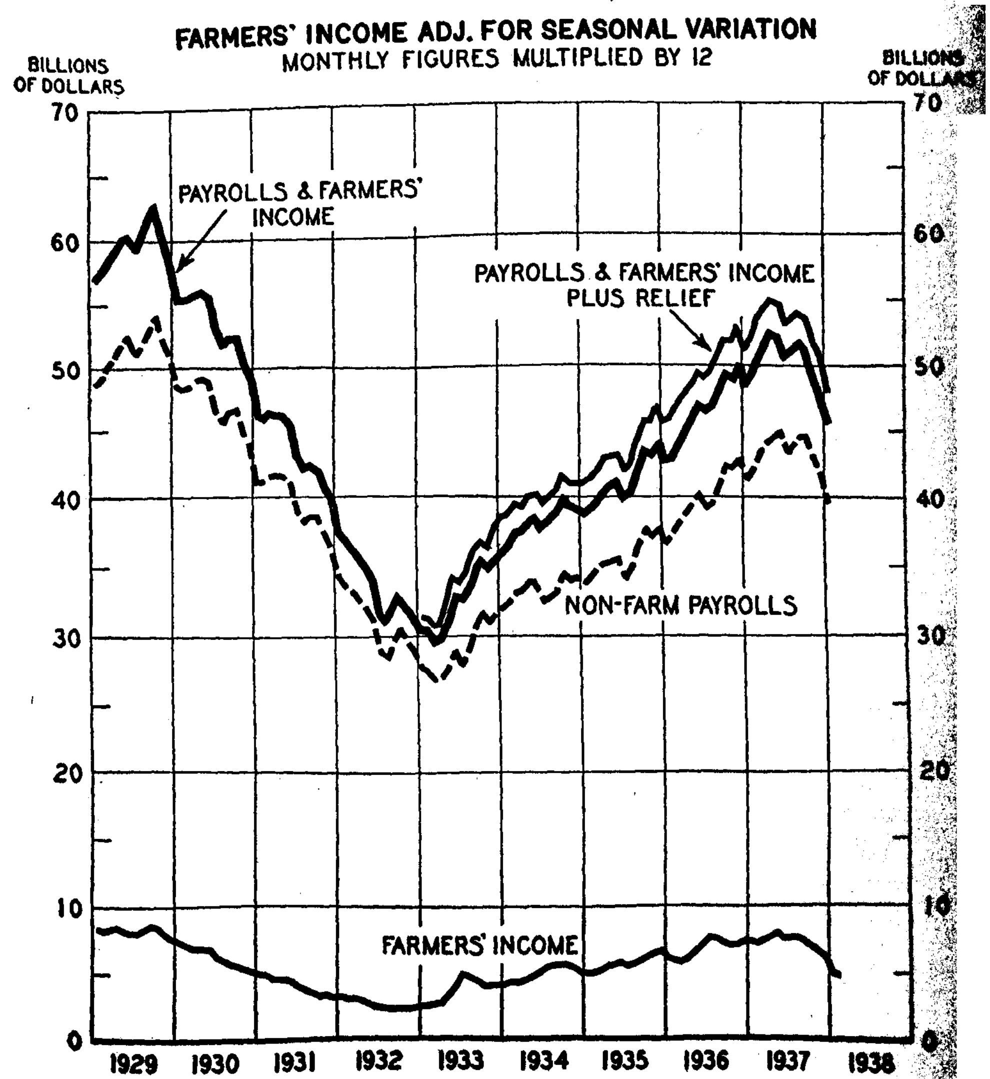
Although a comparison of the years 1927-9 with those of 1922-4 shows no marked change in the objects distribution, the distribution for 1932-4 makes clear that private capital formation represents a relatively unstable element in our economy. I do not include public capital formation as a part of this unstable element for two reasons. (1) Public capital formation may not involve any individual saving in the ordinary sense of voluntary saving. (2) It has sometimes been suggested that public capital formation should act as a balance wheel for private business fluctuations. Let us consider these two propositions. (1) Public capital formation may not involve any individual saving in the ordinary sense. During the nineteen-twenties, public net capital formation, gross new capital goods less an allowance for replacements, amounted to eighteen billion dollars. Most of the funds for this increase were provided through other channels than investment in government bonds, for the total debt of all branches of government remained substantially constant during this period. Government capital formation does not necessarily involve recourse to capital markets. Even if we make a generous allowance for capital sources of funds, such as inheritance taxes and principal payments on international debt account during this period, additions to public tangible assets represent a considerable volume of social saving not involving the ordinary type of individual saving. (2) It has been suggested that public capital formation should act as a balance wheel of private business fluctuations. To act in this way, public capital formation would need to be increased manyfold in a period such as the depression period, 1932-4; whereas when all branches of government are taken into account, and when price changes are allowed for, the increase in the volume of public capital formation was small. Public capital formation did something to promote stability, but not very much.

The distribution of gross national product offers a measure of the importance of the relatively unstable element in our economic system. This element, including consumers' durable goods and making an allowance for increases in the inventories of other consumers' goods, represented nearly 30 per cent of the total in the years 1922-4 and 1927-9 (Chart 1). It shrank in the years 1932-4 to around one-eighth of the nation's gross value product. The instability of this element would undoubtedly be greater were a single-year comparison made. I have not intended to imply that other elements in our gross national product are stable, but only that the instability of the fraction devoted to private new capital goods is particularly great, only that this share accentuates and possibly helps to initiate the cumulative process of expansion and contraction of business activity.

We may turn now to a consideration of monthly measures of shares in the national income and gross value product on which the bulk of our population is largely dependent—measurements representing currently the income of farmers, of non-farm employees, and of persons on relief. Comprehensive measurements of non-farm payroll income have quite recently been made available by the Department of Commerce, and comprehensive measurements of payments since January 1933 to persons in need of relief have recently been made available by the Works Progress Administration (see Chart 2). The

CHART 2

FARMERS' INCOME, TOTAL NON-FARM PAYROLLS, AND TOTAL RELIEF PAYMENTS



SOURCE: DEPT. OF COMM., DEPT. OF AGRI., AND W.P.A.

broken line represents compensation of all non-farm employees except persons who were given employment only on a showing of need for relief. An index of farmers' income prepared by the Department of Agriculture is shown below. It is adjusted for seasonal variations. From the summer of 1929 to the spring of 1933, both non-farm payroll income and farmers' income declined about 55 per cent. By the summer of 1937, non-farm payroll income had recovered to a level about 15 per cent below the 1929 peak, farmers' income to a level 8 per cent below the 1929 peak. Some allowance should be made for differences in price levels in 1937 and 1929, but more than half of the 15 per cent decline in urban cost of living was probably offset by an increase in population. The total of non-farm payrolls and farmers' income is shown by the heavy solid line. For 1933 and succeeding years, when the payroll of persons employed subject to a means test and direct-relief payments are added, we have the total shown by the top line. The exceedingly sharp drop since September amounts to about 6 billion dollars when on a per annum basis.

The introduction on a large scale of direct-relief payments and of public employment subject to a means test creates a problem for the estimator of national income. Direct relief presumably should not be added to the total of payrolls, profits, interest, dividends, and additions to corporate surplus to give total national income, but rather should be treated as a redistribution of a part of the national income. On the other hand, work relief certainly represents, in part at least, a contribution to the total national value product, although the extent of this contribution may be a matter of judgment. In any case, since 1933 both work and direct relief must be included in a total figure designed to represent the sources of income on which the poorest 90 per cent of our population are largely dependent. Contraction in the volume of relief and work-relief payments lagged somewhat behind business recovery. Such payments reached a peak early in 1936.

Current measurements for the objects distribution of gross national product comparable to those on sources of income are not available. A crude indication may be obtained by assuming that consumers' services and consumers' goods correspond roughly to the sum of two magnitudes: rental value of homes,

a fairly stable volume, and total volume of retail trade. Retail trade in 1937 was 60 per cent above the 1933 volume, as estimated by the Department of Commerce. This compares with a combined increase in the total of non-farm payrolls, farmers' income and relief payments of 57 per cent between 1933 and 1937.

The introduction of a vast national relief and works program into our economic system since 1933 represents a broadening of the public-works-as-a-balance-wheel idea to include other types of work beside construction—a broadening, the importance of which economists had not generally recognized until the Civil Works Administration. The contribution made by C. W. A. and W. P. A. to the balance-wheel idea suggests the proverb, "necessity is the mother of invention." An enlarged balance wheel was a necessity, if we were to meet the most extreme cases of financial distress resulting from the prolonged depression and yet avoid the demoralizing effects of a pure direct-relief program. But even this enlarged balance wheel is still clearly a diminutive item as compared to the total gross national product.

Thus far we have devoted our attention largely to the relationships among the various types of distribution at the lower end of the scale, to relationships among such incomes as payrolls and farm profits, the incomes of the poorer and middle classes and the expenditures of income on consumers' goods and services. If existing information is inadequate to trace these relationships, its shortcomings are still more acute in dealing with relationships at the upper end of the scale.

The difficulties involved in these relationships at the upper end bring us back to a proposition with which we started; namely, that the total national income conceived as the sum of the distributive shares (payrolls, interest, profits, dividends, and additions to corporate surplus) and the total national income considered as the sum of consumed income and additions to national wealth should be equal. We may state this proposition differently. The total of the distributive shares, payrolls, etc., plus an appropriate allowance for replacement of wealth used up, should equal the total value of goods and services produced. Still another way to phrase this proposition is: Total investments equal total savings; that is, the increase in our national wealth, including our net external credit, is equal to the increase in equities held by all residents of the country in that national wealth. I am aware that a somewhat heated debate has raged over the question whether savings and investment are equal. But I believe the present trend of opinion is to the view that savings and investment, if consistently defined, are equal; and, similarly, that total national income, conceived as total distributive shares, and total national income, conceived as consumed income plus the increase in national wealth—if these two totals are consistently defined—will be equal. However, consistency of definition is not easy to achieve in terms of our existing information. Indeed, the national income estimates of Kuznets shown on Chart 1 exclude items which some of us are inclined to regard as a part of the national income; namely, such gains as were realized in the stock market in 1928 and early 1929, gains which were widely supposed to have been spent in part upon consumers' goods.

If we attempt to compute saved income in terms of the savings of individuals, as we did the Brookings study for the year 1929, not only may we omit some government saving of tax income, but also—and this may be much more serious—we may include realized capital gains. The result of this inclusion in the Brookings study was an estimate of total savings for 1929 of about 20 billions of dollars, as compared to an indicated saved income on the basis of Kuznets' figures including the increase in the stock of consumers' goods of slightly over 10 billions of dollars. To the individual, capital gains when realized are a form of income which may be either spent or saved; collectively such gains can add nothing to the funds available either for consumption or for new plant and equipment. No one can realize a capital gain of $1000 unless someone else invests $1000 more in the existing physical stock of wealth than was invested in it before.

I shall mention only two other difficulties in comparing savings and investment, and also in comparing the gross national product conceived as the sum of distributive shares and a replacement allowance with the gross national product conceived as a total of the production of consumers' goods (other than dwellings) plus consumers' services plus capital goods produced.

(1) There are major difficulties in identifying the volume of investments by ultimate investors in new capital issues with the value of tangible assets which such issues finance. The investor pays one price; the issuer receives another. Refunding issues and intercorporate duplications must be eliminated. Moreover, we must make an allowance for a volume of new issues equal to old issues retired without refunding.

(2) Existing business accounts may require important adjustments. Additions to corporate surplus and profits of unincorporated enterprises are computed on the basis of prevailing accounting practices. According to these practices provision is made in depreciation and depletion charges for keeping investment intact in a dollar sense. Replacement will be fully and not excessively provided for only if the prices of capital goods remain constant. Thus if our national income accounts are to balance when prices are changing we must in effect substitute replacement accounting for depreciation accounting. Prevailing accounting practices also, as Dr. Kuznets has pointed out, include in profits an item which may fairly be called "unrealized capital gains and losses due to changes in the market value of physical inventories". If our national income accounts are to balance, an adjustment must be made for these as well as for other capital gains and losses.

I mention these various difficulties because I believe that their recognition opens the way to investigations which should shortly give us a much fuller understanding of the relationships between individual and corporate savings and depreciation and depletion allowances on the one hand, and total new capital goods on the other.

Not only are existing measurements incomplete for purposes of tracing the relationships between saved income and new capital goods in retrospect, but also comprehensive current measures at the upper end of the scale are still unavailable. We have heard recently a good deal about the importance of additions to corporate surplus and of security flotations as sources of funds for new capital. I do not underrate these sources. But we should not overlook the fact that automobiles and housing are important forms of new capital goods not largely dependent on these sources of funds, and that the production of these goods as well as of others fell off sharply in the latter part of 1937. We should not forget, also, that investments of business owners in unincorporated enterprises are still a major source of capital funds. More important than all these, depreciation and depletion charges are a source of funds for new capital goods, in so far as securities are not retired dollar-for-dollar with the increase in depreciation and depletion reserves.

Although a comprehensive measurement of the recent volume of new capital goods is not available, some comments are possible. The level achieved by automobiles as an item in the total of private new capital goods in 1937 was exceptional. Unlike most other durable goods the level was less than 10 per cent below that of 1929 if we omit exported vehicles (which do not count as capital goods for this purpose). For an overall picture of gross capital formation we should, of course, include increases in business inventories. These also were in 1937 at levels quite comparable with those of 1929.

If we take a longer-run view, we may note that an examination of Kuznets' estimates of net new capital goods after allowance for replacements tends to confirm a position to which a variety of other sources of information contributes. Our stock of plant and equipment was low after the war. It grew far more rapidly than population during the nineteen-twenties. It reached a peak in 1930 (the housing peak came somewhat earlier). It declined during the prolonged depression, then rose again, and is today probably at about the level of 1930. Although at best recovery during the next few months may be slow, it is difficult to avoid the conclusion that if, as, and when recovery gets under way again, that relatively unstable element in our gross national product, the volume of private new capital goods, is likely to show a marked expansion to meet an accumulated deficit. Although such an expansion may offer a basis for a period of recovery and prosperity lasting several years, we must not forget the possibility of a subsequent contraction.

The immediate future appears to promise rapid progress in our statistical understanding of the relationships between savings and new capital goods. Perhaps we may hope that that improved statistical understanding will implement new social techniques for the stabilization of the unstable element in our gross national product.

Remarks by the Chairman

Chairman Mitchell: One of the interesting developments in business administration during the last generation has been the increasing frequency with which corporations have employed statistical experts as members of their regular staffs. This practice has benefited the science of statistics; for statisticians who are engaged day by day in applying their technical methods to the problems of business life have opportunity to get a realistic understanding of what figures mean that their academic colleagues often envy. On the other side they develop perforce a sense of responsibility, which I fear their academic colleagues are glad to be spared.

One of the most notable of the statisticians who has applied his energies to business affairs is Mr. John Scoville, whom I have the honor of introducing to speak upon "Technology and the Volume of Employment". The industry in which he has worked presents our most striking example of rapid technological progress combined with increasing volume of output and employment. These are matters of which Mr. Scoville can speak with intimate knowledge derived from personal participation in the development of a great enterprise. Mr. Scoville!

TECHNOLOGY AND THE VOLUME OF EMPLOYMENT

JOHN SCOVILLE
Chrysler Corporation, Detroit

I would like to start this discussion by asking three questions. Can the standard of living of the American people be raised by destroying existing wealth? Can the standard of living be raised by decreasing production? Can the standard of living be raised by doing useless work? You say, these are foolish questions. No one can believe that we can become more wealthy by destroying wealth, that we can consume more by producing less, that we can promote our welfare by labor which is barren and yields nothing of value! Yet millions of people do believe these things; these tenets of the philosophy of scarcity are widely accepted, promulgated in legislatures and incorporated in the laws of the land.

At the present time, automobile production is at a low level, and on every side we hear people clamoring for the destruction of the older cars now in use in order to revive production. The following quotation is from the February Bulletin of the National Automobile Dealers Association: " Industry Junking Plan a Necessity! Replacement market requires systematic elimination of obsolete used motor vehicles to provide outlet for new automobiles. 11,000,000 out-moded cars and trucks, now in use, offer impregnable resistance to further penetration." In Brazil thousands of tons of coffee are destroyed annually. We plowed up cotton and killed little pigs by government decree. But even more popular than the movements for destroying existing wealth is the drive to slow down the production of goods and to reduce the supply of goods and services. Government enacts tariff laws to restrict the importation of goods from abroad, in order that goods may be scarce. Subsidies are paid to farmers who will restrict their crops, in

order that farm products may be scarce. There is agitation for laws to restrict factory work to 30 hours a week to make labor scarce. Labor unions clamor for shorter hours, slower speeds, fewer apprentices, craft monopolies — to make labor scarce and to slow up production. In the professions unduly long courses of study are prescribed in order to discourage new entrants.

But the apostles of scarcity are not content with the destruction of wealth and a decline in the production of new wealth; they also advocate that labor shall be barren, that men shall work without producing anything of value. If in a factory, 100 hours of labor are used to produce goods which could be made with 50 hours of labor, then I say that 50 per cent of this labor is barren. Strange as it may appear, there seems to be a considerable sentiment in this country in favor of useless labor. On March 14, 1934, local union No. 106 from Harrisburg, Illinois, sent a letter to President Roosevelt from which I quote: " Remove the loading machines from the coal mines, complete all public work with man power, take the tractor off the farms, go into the various industries and remove enough labor-displacing machines to make employment for labor." In February 1936, Congressmen solemnly listened to arguments on House Resolution 49 in which the Secretary of Labor was requested (1) to compile a list of the labor-saving devices put in operation after December 31, 1912, which are still in use, (2) to estimate the number of persons now unemployed by reason of these devices, (3) to estimate how many more persons would be employed if these devices were eliminated.

The Congressman who introduced this resolution said: " You will note that I am trying to ascertain the number of men that each and every machine supplants in order that each machine may be taxed according to the man power that it supplants, if it is necessary to place a tax. If one machine supplants one man you might tax it, as an illustration, 10 cents or $1.00, but if another machine supplants 20 men, it should be taxed 20 times as much." The purpose of taxing labor-saving machines is to reduce the amount of unemployment. But there is every reason for thinking that this aim would not be realized. Labor-saving machinery is used in manufacturing, in transportation and in agriculture. A tax on labor-saving machines would increase the cost of food, clothing, and practically everything else. At the higher costs, fewer things made by machines would be bought and fewer of these things would be made. Suppose that 4,000,000 automobiles are bought in a year at an average price of $800. Now suppose that the labor-saving devices used in manufacture were taxed so that the automobile would sell for $1200. This would reduce the annual output so much that employment in automobile factories would decline. It is almost certain that a tax on labor-saving machines would cause a decline in employment.

There is a fundamental fallacy in the thinking of those who advocate the taxing of labor-saving machines, a compulsory 30-hour week, minimum wages and maximum hours and other schemes for improving the condition of labor. The fallacy consists in the assumption that there is a demand for a fixed total amount of goods and services, that there is a demand for some fixed amount of labor and that the only problem is to parcel out this labor demand among the workers. Of the fifty million gainfully employed in this country, only about eight million are engaged in manufacture. Suppose that the wages of the eight million people engaged in manufacturing were doubled and that the prices of manufactured articles were thereby nearly doubled. Then the eight million workers in factories could buy more manufactured products; but the forty-two million, at the higher costs, would buy fewer manufactured products and the total output of our factories would decline and many of the eight million factory workers would lose their jobs. If this experiment could be performed, we would have proof that the purchasing power theory of prosperity is fallacious and that unemployment results when wage rates in certain occupations are too high. It is a popular fallacy that factories pay wages. Factories are labor brokers, buying labor for the account of others; they collect money from consumers and pay this money over to workmen. The just wage rate is obtained when the income of the factory worker is in balance with the income of the consumer who buys the product. It is a popular fallacy that prosperity comes from high money wages. But the facts are that any deviation, up or down, from the

just wage lowers the standard of living. The just wage tends to be established in a competitive society, free from all forms of coercion, restriction and regulation in which no group is able to use the power of government to exact tribute from the other groups.

But before we tax machines to promote useless labor, let us consider the alternatives. We might compel a manufacturer who installs a labor-saving device to place beside it an exercising device, say a rowing machine or a punching bag, so that the worker could operate the machine for an hour and then spend the time saved by the labor-saving machine working on the rowing machine. This would accomplish the desired result of giving employment without any useful production of goods.

Another scheme that would accomplish similar results would be to compel manufacturers to lower the durability of goods. Suppose that we make it unlawful for a tire manufacturer to make tires that will last more than 5,000 miles. Compel car manufacturers to make automobiles so poorly that they will fall apart after three or four years. Compel builders to make houses so poorly that they will tumble down after fifteen years. Many avenues are available for the promotion of useless work.

In November 1937, a Congressman from Texas said: " I am introducing a bill today—not a bill that I would be willing to have passed, but a bill simply presenting for consideration the principle, because I would not undertake to write out in detail a bill unless we want to do something about it. I am introducing this bill today that will stop for the time being the bidding on the part of the Federal Government for some more idle people. I am offering the bill to stop the issue of patents on the part of the Federal Government in labor-saving devices." It seems to me the Congressman is getting into action too late. He should have been here a few thousand years ago when our ancestors domesticated the horse. Think how many men were displaced when our ancestors began to haul logs around with horses! Is it not true that Watt and Arkwright and Fulton and Howe and Edison and all the other inventors have dealt such devastating blows at human bondage that only pitiful remnants of sweat and toil can be saved from the wreckage? Is it not too late to transfer the crown from Emperor Brains to Old King Brawn?

But has the Congressman considered the alternatives? Can we not set aside some large area, let us say the state of Texas, and in this state forbid the use of mowing machines, automobiles, telegraphs, telephones, railroads, electric motors, sewing machines, and all other labor-saving devices. Then let all those who want to do things the hard way emigrate to this state and try the experiment. Let the man in El Paso who wants to send a message to Texarkana get a messenger boy on a bicycle to deliver the message—no, the bicycle would save labor; let him take the message on horseback—no, the horse saves labor; well, let the boy carry the message on foot like a Marathon runner. Then, if the people there enjoyed the plan of doing more work in order to have less, there might be an irresistible demand from the other states to extend the system. I understand there are still areas in North America where wagons are drawn by oxen and the housewife spins her own yarn and weaves the cloth. Perhaps those who object to labor-saving devices could be induced to move to those more favored regions where the handicraft methods still prevail! The Navaho Indians have been very successful in resisting the ravages of the machine age. Perhaps they would adopt into the tribe a limited number of white brothers who yearn for the primitive ways of life!

Now this idea of promoting useless work is nothing new; the Egyptians used the idea very successfully in building the pyramids. Today we still build pyramids, some of which have a small residuum of utility. This great movement for the promotion of useless work may break out in many forms. Over two hundred years ago the workmen smashed up the machines for spinning and weaving. Today we pass laws to compel the employment of extra men on trains and street cars. We prevent the use of spray guns in painting buildings. We demand that the brush used in painting shall be narrow. I read some time ago that the United States Senate refused to have the nation's capital desecrated by such a devilish contraption as a dial telephone.

Some time ago I was visited by a research man who wanted me to help him make a study of the increase in the productivity

of labor in the automobile industry. I told him that whenever a factory introduced a new machine, it was always with the purpose of making the article better and more easily. So far as I knew, we never knowingly put in machines to make it more difficult to make things. I was sure that we did not need a federal investigation to prove that industry through the years has been successful in making things better and with less effort. I pointed out various difficulties, one being that the cars we make now are much superior to the ones we used to make. How could we possibly analyze the technological advances, from the mining of copper, the digging of iron ore, the production of rubber, all the way along through the steel mills, the tire factories, the paint factories right through to the finished car? How could we do it? But suppose we could overcome the difficulties and find out how much the productivity of labor had increased, what use could anyone make of the information after it was compiled? I think he said it would be handy information to have, that some one might call for it. Now I see why the information is needed. The man who buys the car pays a license tax, an excise tax, and often a sales tax. If he wants to run the car, he pays a tax on gasoline. The workmen who make the cars pay a tax on their wages. The corporation pays a property tax, a profits tax, a tax on undistributed profits, a tax on surplus and a payroll tax. The stockholders pay a tax on the dividends. There was only one thing left to tax—the machines that were used in making the cars!

In some future year, I can hear a tax inspector inquiring of a foreman: "How many hammers are used in this department?"

"We have 10 hammers in all."

"How many of these hammers were installed since 1912?"

"All but one, inspector. This old hammer in my hand I bought 30 years ago."

"All right, no tax on that. The other 9 are taxed 50 cents apiece."

"Why are they taxed, inspector?"

"Well these hammers save labor, don't they? You don't have to use a hammer to drive a nail. You could drive these nails in with a big stone. That would create more employment. It would take longer to drive the nails with a stone, wouldn't it? And besides, it would take some time to find the stone."

"Would we have to pay taxes if we drove the nails in with big stones?"

"Of course not. When you fellows get back to the stone age, there won't be any more taxes."

Have the advocates of a tax on labor-saving machines thought of the farmers? A modern combine would displace hundreds of men cutting grain with a sickle. A modern threshing machine would do the work of more than a hundred men threshing grain with a flail. A century ago about 75 per cent of our people were farmers. Today only about 20 per cent are farmers. Improvements in agricultural technology have driven about 64,000,000 people off the farms, and have thrown about 16,000,000 farmers out of work. Of course these displaced farmers did not go on relief. They went to the cities and built the automobiles, radios, farm machinery and other manufactured articles, printed the newspapers, strung the telephone wires. Yet there are those who would bite the hand that feeds them, who would pull down the ladder by which men have risen from the condition of peasants to the comforts and conveniences of modern life.

In any discussion of technology and the volume of employment, it may be well to consider what these words mean. I understand technology to mean all those inventions, discoveries and methods which give us new products or which enable us to improve old products or to make them with less effort. But what do we mean by employment? Do we mean all human effort directed to the satisfaction of human desires? If so, we must include the work done by the millions of housewives who cook the food, tend the children and mend the clothes; we must include the work of the great grandmother who knits a sweater and of the child who feeds the chickens. On this basis there are over 80,000,000 people in this country employed in some kind of work. Now if a woman does her own housework, she is not gainfully employed, but if she works in an office and hires a maid to do the housework, they are both gainfully employed. So if we omit the housewives and the young and the old

workers in the homes and on the farms, we have a residue of about 50,000,000 who are called the gainfully employed. Most of the farmers, small shop keepers, physicians, lawyers, etc., operate their own businesses; they do not work for wages. If these independent operators are eliminated, we have about 35,000,000 left who work for wages, in money or in kind. From these we can eliminate the school teachers, salesmen and clerks in stores, government employees, carpenters, masons and others in the building industry, domestic servants and a host of others, and we have a residue of about 8,000,000 who work in manufacturing establishments. It is this small residue which is usually considered when we talk about hours, wages and the trend of employment. In 1929 the number of persons employed in manufacturing was about 8,785,000 and in the fall of 1937 this number was about 8,100,000. The November census of unemployment indicated about 10,000,000 people out of work. Since factory employment in 1937 was only about 685,000 less than in 1929, it is evident that these 10,000,000 unemployed persons have not been discharged from factories and cannot expect to get work in factories. The number of unemployed in November 1937 was a million greater than the maximum number ever employed in factories. Since factory workers are only about one sixth of the gainfully employed and only about one ninth of the total workers, it is evident that statistics on factory employment give a very incomplete picture of employment.

Another difficulty in defining or measuring employment is that very few persons are fully employed. A clerk in a store or an attendant at a gas station may spend half of his time waiting for customers. Farmers do very little work in the winter or on rainy days. Many teachers are on vacation for several months of the year. The stenographer may spend considerable time in gossip and novel reading. The executive may spend considerable time in telling funny stories. Most of the persons classified by the census as employed are not fully employed. Many of them have jobs, but they do not work very hard. Then there are the faithful workers who do not accomplish much because they lack the necessary skill or intelligence, or do not have proper equipment. The output of many workers is low in quality and quantity. Some employed persons are engaged in criminal or anti-social work. Others who are employed are social parasites engaged in useless work; and, of those engaged in useful work, some are doing things of great value and others are doing work of negligible value.

So when we talk about employment, we do not know what it is we are talking about. The concept is a very nebulous one, and it is hard to measure something which we cannot define. If we define employment as the useful work done, then measures which we have greatly exaggerate the fluctuations in employment. From 1929 to 1933 the factory employment, according to the U. S. Bureau of Labor Statistics, declined by about 40 per cent. But the farmers worked about as hard and produced about as much in 1932 as in 1929. The housewives probably do more work in depression years. They do the washing at home instead of sending it to the laundry, they bake bread instead of buying of the grocer, they make dresses instead of buying ready-made dresses. The workman discharged from the factory may be spending his time in painting his house, making a garden or repairing his automobile.

The total hours of work never rise as high or fall as low as the published statistics indicate. Likewise, the published figures on industrial production exaggerate the fluctuations in the work done. These figures show the output of certain mines and factories. They do not include the output of small establishments, the production carried on in the homes and on the farms. They do not show the work done by service industries, merchants, professional people and government employees.

I believe our statistics on unemployment give an exaggerated picture. When I was a boy, there were many men in the village who did not do much work. They did odd jobs, they were assisted by relatives and they managed to get along. They did not starve. Today, many people similarly situated are on relief. They are analyzed by age, sex, color and marital status. They are counted, classified, analyzed and surveyed. They are an important political force, the wards of a paternalistic government and the raw material for scholarly dissertations.

Let us take an imaginary trip to an imaginary island—somewhere in the South Seas—an island where the people live on fish. As we leave the ship and walk into the village, we find many of the natives with emaciated bodies and listless sunken eyes. Much of the population is in dire poverty and a casual check-up shows that about one third of the natives are ill-fed. We go to one of the oldest inhabitants to seek the cause of the distress. He tells us that in years gone by the natives were prosperous and happy, and that the able-bodied worked every day at fishing. But an inventive native had discovered that by putting several fish hooks on each line, the daily catch had been doubled and trebled. Not being able to eat all the fish, the natives had built huge warehouses, and these warehouses were bulging with unmanageable surpluses of smoked, pickled and dried fish. The old native said the island was suffering a great depression due to several causes! First, consumption could not keep up with production, they were unable to consume as many fish as they could catch; second, there were huge surpluses of fish in the warehouses, which kept the fishermen from their jobs of catching more fish; third, there was a general overproduction of fish; fourth, the improved technology had prevented the fishermen from working as many hours as formerly in supplying themselves with fish, thus creating a great problem of unemployment.

Having recently come from the United States, we can readily understand the calamity which had overtaken this island. We asked the old native what remedial measures were being undertaken. He said that a number of bright young men had been studying the problem. First, they made a survey. They discovered that the multiple hooks had increased the average hourly catch from 1.765 pounds to 3.498 pounds; that the average numbers of hours per day spent in fishing had been reduced from 8.274 to 5.347 and that 33.333 per cent of the people could not get enough fish to eat. After this factual analysis had been made, a program for solving the problem was easy. It was decreed that no man should fish more than four hours a day; that any fisherman who would agree to limit his catch to two pounds a day would receive six large fish a month as a benefit payment from the government; that any fisherman who used more than one hook should deposit one fish per day in a government warehouse for each hook used in excess of one; that every householder must keep ten cats to enable the consumption of fish to keep up with production; and that any citizens who did not like to fish could get their fish from the government warehouse.

I understand that a huge sum has been expended in trying to discover how much productivity in this country has been raised in recent years through technological advances. I am not greatly interested in the statistics of this problem. I know we are on a one-way street—that when we find an easy way of doing something we never go back to the hard way, unless we are compelled to. I would like to see technology advance so that all the things we need could be produced in abundance by a self-repairing automatic machine that would require no labor whatever. Under these conditions employment would be zero and everyone could have all he wanted, for the goods produced would cost nothing. No one would want to be rich, for the goods he accumulated would have no value. I do not believe that labor is something to be encouraged or fostered or promoted. My own Utopia would be a workless world. I do not believe that labor-saving machines create employment. That would be a contradiction in terms. Labor-saving machines give us either more goods or more leisure. In this country, labor-saving devices have given us both more leisure and also more things to consume; and more leisure and more wealth mean a higher standard of living.

Back in 1910 the work week in Detroit was 60 hours. In a few years it was shortened to 58, to 54 and finally 50. Now it is about 40 hours a week. This shortening of the work week was the result of technology and better management and not of legislation. Many people believe that technological advance causes unemployment, and most people have exaggerated notions of the extent to which machines have increased the productivity of human labor in recent years. Some of these productivity studies take 1920 as the base year and show a great increase of productivity from 1920 to 1922. But 1920 was a year when labor was scarce, independent and inefficient. In 1920 the newspapers carried campaigns for increasing the

productivity of labor. In Detroit, factories would send busses to rival plants to entice workers and persuade them to change jobs. Labor was scarce. Then came the chastening effects of the depression of 1921. In 1922 labor was more efficient. But from 1922 to 1935, a study directed by David Weintraub indicates that the productivity of wage-workers increased by about 12 per cent or about 1 per cent a year and the productivity of all workers, including the self-employed, increased about 5 per cent in thirteen years. Labor-saving machines may cause the temporary unemployment of certain persons, but I know of no evidence to prove that labor-saving devices cause general or protracted unemployment. Technology has made enormous strides in the last 40 years; yet census figures show that the percentage of the population gainfully employed was 38.3 in 1900, 41.5 in 1910, 39.4 in 1920 and 39.8 in 1930. If labor-saving devices cause unemployment, then we should have the greatest unemployment now in the states which have the highest percentage of the gainful workers in manufacturing and mechanical pursuits. But according to the census of the unemployed made in November 1937, in the 16 states with the highest percentage of the workers engaged in manufacturing, the unemployed are 16.3 per cent of the gainful workers in these states in 1930; and in the 16 states which had the lowest percentage of the workers engaged in manufacturing, the unemployed amount to 16.8 per cent of the gainful workers reported in 1930. In the states where 36.9 per cent of the workers are engaged in manufacturing, only 16.3 per cent are unemployed, and in the states in which only 16.2 per cent are engaged in manufacturing, 16.87 per cent are unemployed. The states showing the largest percentage of workers unemployed in November 1937 are Montana, Kentucky, New Mexico, West Virginia, South Dakota, Oklahoma and Pennsylvania. Comparing the number of unemployed in November 1937 with the unemployed in 1930, we find that in the 16 states most highly industrialized, the number of unemployed has doubled, and in the 16 states with the least manufacturing, the number of unemployed has quadrupled. If machines cause unemployment, we would not expect to find the least unemployment in the states where there is the most machinery.

Technology is a much broader term than labor-saving machines. When the camera was invented, something new was given to mankind. Now all the people engaged in making cameras, photographic materials and moving pictures are giving us something that did not exist before. The automobile did not give us something new; we could travel before the automobile came. But with the automobile we travel a lot more. The automobile enormously increased the mobility of people. While there are fewer people employed on railroads than were employed twenty years ago, there are many more people employed now in transportation.

Over in Russia they have a government organized for the purpose of improving the lot of the common people; and they have been working feverishly to build more and more machines. They apparently do not share the views of our own parlor intellectuals, who, sitting in chairs made by machines, wearing clothes and shoes made by machines, and smoking cigars made by machines, write reports on paper made by machines, to be printed by machines and distributed by machines, in which they discourse on the evils of the machine age.

You know, if machines are really evils to be restricted, taxed and condemned, then the individual who buys these machine-made products is not without guilt. If there should be legislation to restrict the use of labor-saving devices, the government might find its own operations considerably hampered. It might be necessary to throw out the stamp-cancelling machines from the post offices, the tabulating machines from the Bureau of the Census, and to write the Congressional Record on parchment with a quill.

In the pamphlet on *Unemployment and Increasing Productivity* by David Weintraub the statement is made that the volume of goods and services produced per capita in 1935 was only 96 per cent of the figure for 1920. This does not mean that we had a lower standard of living in 1935 than in 1920. Comparing 1935 with 1920, we had in 1935 an increase of 22.5 per cent in school enrollment, an increase of 161 per cent in college enrollment, an increase of 185 per cent in the number of motor vehicles registered, an increase of 137 per cent in the volume of life insurance in force, an increase of 31 per cent

in the number of telephones in use, an increase of 128 per cent in the production of electricity, and an increase of 2450 per cent in the production of rayon. In 1935 we had more vacuum cleaners and electric washers in homes, more radios, more tractors and combines on the farms. We were eating more citrus fruits and more green vegetables in the winter.

It is important to note that the figures on national income or productivity do not measure the well-being of the people or the level of consumption. Suppose a new school house is built in a city. The cost of this building becomes a part of the national income for that year, but it may take fifty years to utilize or "consume" this building. In 1929 there was a record production of automobiles, which increased the national income in 1929, but these automobiles have not yet been "consumed". The figures on national income exaggerate the fluctuations in consumption. If we could make our buildings, bridges, highways, furniture, motor cars and farm machinery so that these goods were indestructible, then we could have a rising standard of living accompanied by a decline in production and a decline in national income.

In 1929 this country entered a great depression. Many volumes have been written on industrial depression. The causes are complex and obscure. I am not enough of a scholar to understand all the causes of these great social and economic catastrophes. In my opinion, we never really emerged from the great depression which started in 1929. After 1932, production and employment increased. By the middle of 1937, most of the factors were present which are supposed to insure prosperity. Interest rates were low, the banks were bulging with deposits, wages had been raised spectacularly and the purchasing power of labor was high, the security exchanges were under supervision, farm prices were in line with industrial prices, crops were bountiful, farmers were being regulated and subsidized, collective bargaining was being extended by law. Then business went into a tail spin and in the past four months we have witnessed the most violent decline in business activity ever experienced in this country. The number of unemployed today is about as great as five years ago, at the depth of the depression. It would be folly to assume that several million people lost their jobs in the last few months because of the introduction of labor-saving machines. Steel workers lost their jobs because we reduced the output of steel; automobile workers were thrown out of work because people bought fewer cars. Employment is down, not because machines are doing work formerly done by man—but because the work just is not being done.

If a farmer did not plow his fields or cut his hay, he could not blame his idleness on the plow or the mowing machine. Sometimes I think the hue and cry against machines is for the purpose of obscuring the real causes of our distress. By no stretch of the imagination can we conclude that enough labor-saving devices were installed from 1929 to 1933 to throw 12,000,000 people out of work. And if machines were not the cause of the great number of unemployed in 1933, it is not likely that they caused the continuance of much of that unemployment from 1933 to now. The unemployment of the last eight years obviously has not been caused by labor-saving devices; and the progress in the arts and sciences, in the increased standard of living, in the humanities, in increased general health of the people, in fact all the progress in material things that have characterized this age, rests essentially on the industrialism which is its outstanding feature. The progress of the industrial age rests on the greater diversification of labor and the use of more elaborate tools and machinery which have increased productivity—in other words, saved labor. It is not the purpose of this paper to discuss the factors which from time to time have marred the progress made in this industrial age, but in our attempt to cure the social ills, we should not kill the goose that has laid the golden eggs. If our society is sick, it is for other reasons than the conquest by man of the forces of nature.

Remarks by the Chairman

Chairman Mitchell: The concluding topic of the afternoon's program, " Competition or Monopoly ", is one that has been debated for a generation or more as actively as any other economic topic—debated often with more vigor than insight.

Among the professional students of economic problems there is no one who has devoted more genuine thought and keener analysis to the effects produced by monopolistic and competitive practices than Professor Frank A. Fetter—a professor *emeritus* who still speaks with the force and charm that made him a famous college debater in his undergraduate days. Professor Fetter!

COMPETITION OR MONOPOLY

FRANK ALBERT FETTER

Professor of Political Economy, Emeritus, Princeton University

Relativity of Competition and Monopoly

MUCH confusion in the discussion of this subject results from the failure to recognize the looseness of the terms competition and monopoly as used in connection with many practical business situations. The competition we are talking about is *fair* competition, carried on in the light of day and obedient to the rules of the game laid down by society as most in harmony with the public good. It is not unregulated laissez faire. It is not pseudo-competition, fake competition, monopoly dressed in the robes of competition, and merely paying to competition the shallow compliment of imitating its gestures and phrases.*

Another great source of confusion in the discussion of this subject would be removed if it were recognized that competition and monopoly are always more or less qualified, modified and intermingled in any real market situation. It is hardly possible to discover in fact or to conceive of absolute monopoly in the sense of unlimited power to set any price desired. Always there are some practical limits to the power to induce or to compel the consumer to go on buying at a higher price. Always there is the limit of " what the traffic will bear ". At almost every point as prices are raised, substitution of goods of different quality or kind increases, and buyers cease to buy the same goods in the same quantities as before. Also potential competition is stimulated to take the risks of breaking into the monopolistic paradise. Such competitors it is fashionable to call " chiselers " since, in some business circles, it has become " unethical " to compete against monopoly.

* See further the writer's paper " The Truth about Competition ", printed in *The Annals of the American Academy of Political and Social Science*, January, 1933; also *The Masquerade of Monopoly*, chapter 19, " Markets and Competitive Prices ".

It is often argued in and out of court as if evidence of any sort of competition, however weak and restricted, proves that there is no monopoly whatever in an industry or in a practice. The truth is that monopolistic power is never unlimited, but even a quite moderate degree of it may be immensely profitable to sellers and very burdensome to the public.

Recent Weakening of Competition

No one with knowledge of present conditions seriously denies that fair competition has been gradually weakened in the last three quarters of a century, and monopoly control over prices, wages and markets has been greatly enlarged. To the free movement of individual and independent enterprise and of price-making forces many hindrances have been interposed. (1) By political action barring some men from doing perfectly honest sorts of things which they would like to do. Notable examples are tariff legislation and the growing mass of special state licensing provisions in many occupations. Although such measures are always advocated in generous terms as necessary to protect the health or welfare of the buying public, they are, with few exceptions, adopted because of political pressure from sellers selfishly seeking higher wages or profits for themselves. (2) Hindrances to free competition have arisen from changing technical conditions, as in the public utilities. So expensive is the local physical plant required to deliver the services of these industries to the customers, and so wasteful is the duplication of such facilities that the public can only recognize such industries as " natural " monopolies and attempt to control them as best it can—not very successfully as yet. (3) Ever greater have grown the private and corporate hindrances to free competition that are set up by means of mergers, agreements, and newly devised business practices, largely made possible by recent changes in the law of industrial corporations. Everyone here could multiply illustrations of these increasing hindrances to competition.

Competition versus Monopoly as Public Price Policy

Which is preferable as a *general* public policy with respect to enterprise, markets, and the determination of industrial prices, wherever and whenever possible of realization, competition or monopoly? Can there be the slightest doubt? The answer must be: competition, free and fair. Everyone, even the most ardent monopolist, heartily agrees that competition is a good thing in the production and sale of everything that he buys; he prefers monopoly only for himself in the sale of his own products. One must often wonder whether the members of the National Society of Lobbyists have entirely lost their sense of humor when they appeal to the government for tariffs, subsidies, land grants, financial reconstruction loans, and special privileges or charters of many kinds and in the same breath denounce every grant of public favors to humble citizens as subversive of the Amercian spirit of independence. Our troubles regarding public price policy might begin to vanish if more men in influential positions in business and organized labor could realize that we cannot go on trying to play the business game with two sets of rules—one for the weak and another for the strong, one for our organized pressure groups and another for other folks less effectively organized. That can hardly be called a game.

The reasons why fair competition is better than monopoly as a general and long-run social policy are pretty generally understood and conceded, the more so since our recent tribulations. Even those who have done, and are doing, most to weaken the competitive system admit in the abstract that fair competition makes for enterprise, plenty and progress, whereas widespread monopoly tends toward scarcity and ultimate stagnation. That means that competition is not only a prerequisite of a rising standard of living, but is an essential condition for maintaining even the standard already attained. The apparition of the totalitarian states has shown how closely related is the condition of free enterprise and fair competition to political and spiritual freedom. Instead of looking upon our democratic society as a finished work which will endure forever without further effort on our part, we have suddenly been made to realize how imperfect and fragile it is, and how much needing the unremitting efforts of each succeeding generation in its defense if the blessings of liberty are to be preserved for ourselves and our posterity.

The era of universal voting franchise into which we have entered involves new dangers to the survival of free institutions, both economic and political. The masses want the visible and immediate results of progress and are not either exceedingly patient or farsighted. Particularly in an acute period of temporary depression, discontent is magnified. A society politically democratic, but in which a large share of the fruits of scientific and technological progress mysteriously disappears instead of being passed along in due measure to the common man, is headed for self-destruction.

Monopoly's Part in Causing Depressions

The question has often been asked in recent years: Can capitalism survive? As a chain is no stronger than its weakest link, so capitalism (if that be the name of the existing complex business organization) is in danger of crashing under the weight of a business depression like the present one. The strain upon the democratic structure at such times is terrific, as all the world gives witness. Is there anyone, the most conservative, who has not of late had grave fears that something like a revolution might come before recovery? Have not these fears been renewed and accentuated by the recent recession and the stubborn fact of ten million unemployed and the necessity of continuing enormous doles and treasury deficits after nearly nine years of depression?

Two questions should be distinguished: What caused the collapse in 1929 (or the recession in 1937), and how can it be mitigated or ended? However rash it is to attempt to answer these questions, I venture the opinion that monopoly is not the sole or even the chief cause of financial depressions, although it has some part in causing them. The chief evil effect of monopoly is its long-time, steadily retarding effect on the reduction of the prices which it controls. It distorts the normal equilibrium of the competitive price system. The chief evil of monopoly is secular and lasting rather than catastrophic and temporary. A sudden shock to the whole price system such as that of 1929 and 1937 is not a simple result of forces that have been steadily operating for over a half-century, during several business cycles.

More probably the major fluctuations of the business cycle are mainly due to general monetary causes, including in that term the excesses of credit and of speculative investment. So enormous has become the volume of outstanding dollar indebtedness which links together the banking system, public finance, private business, the vast contractual fixed charges of corporation bonds, and all forms of capitalized incomes, that the whole business system has become a house of cards. If some parts get badly out of balance, the whole structure may topple. The growth both of monopoly and of business depressions is aided and intensified by the overgrowth and abuses of the business corporation device and the excesses of credit. Enterprises are controlled by those who no longer, as was once the rule, carry the burden of investment. They are able by the issue of long-time, virtually unamortized bonds, to own or control business on a margin—often on a shoe string. Every issue of long-time bonds is a gamble on the chance that the earnings may be enough to carry the contractually fixed charges in poor times. Of late the burden of such charges due to excessive corporation indebtedness is often pleaded as the justification for monopolistic control of prices in periods of depression, as if imprudent contracts with creditors created a moral right to exploit the consumers and to violate the anti-trust laws. Other abuses of the corporation device have made possible also the excessive centralization of financial control and the great reduction in the number of independent sellers which is the prime cause for the weakening and disappearance of competition in so many lines of industry. Everywhere throughout the price system, monopolistic control tends to upset the automatic tendency toward equilibrium which is the vital principle of true capitalism.

Monopoly's Part in Aggravating and Prolonging Depressions

Monopoly's share of the guilt for aggravating and prolonging industrial depressions is probably greater than is that for their inception. The best economic opinion of the world is agreed at least on this one point, that once a national or world organization has got into a state of financial depression, the quickest way to get it out would be to give free play to the forces of demand and supply in the markets. Artificially to "stabilize" prices in an industry with unused capacity is

further to unstabilize production and employment in that industry. If all business, not only our own but that of countries with which we trade, were on a cash basis, if there were no outstanding debts, no rigid wages and prices, and no fixed contractual obligations in terms of dollars, there seems reason to think that such a thing as a financial depression would be both mild and brief, if, indeed, possible at all. Disturbances of trade due to such political disasters as war or to great physical catastrophies might, of course, still occur. But all sorts of artificial price rigidities have multiplied in the last century. Inflexible rates fixed by public utility commissions regardless of general price changes are a large factor. The latest arrival, and in some ways the worst, is the stabilizing of certain prices and wages by private monopolistic action, in disregard of other industries and occupations and of the general welfare. Monopolistic industry is for itself, and the devil take the hindmost, and the hindmost are those without monopoly power.

Exactly the same is true of the monopolistic control of wages in an occupation where there is already unemployment. Production shrinks and the blight of unemployment spreads. This is an elementary economic principle and a stupendous practical reality. Owners of idle factories and groups of idle workers collectively defeat their own purposes when they use whatever monopoly power they have to maintain prices and wages in times of depression; and further they thereby mutually aggravate their own troubles as well as the disasters of the whole community. Great key industries and occupations, such as building materials and the building trades, narrow the neck of the industrial bottle through which must flow the production and employment of many related industries and occupations. Employers can see the evil of monopoly wages in their factories; workers can see the evil of monopoly prices for the things they want to buy. Each can see the mote in his neighbor's eye but not the beam in his own eye. It is safe to say that current popular doctrines in business, labor and political circles regarding the benefits of artificially increasing and "stabilizing" wages and prices above a true equilibrium level are responsible in large part for the increasing severity, greater amount of unemployment, and excessive duration of modern industrial depressions. The general level of real wages cannot be raised by presidential ukase.

It has been one of the stock claims of virtue for the monopolistic stabilizing of prices that it helps to stabilize the whole price level. Since the fallacy of this is being recognized, the effort now is rather to demonstrate that there is no monopolistic price control during depressions, excepting, of course, that of wages. It is true that cartels and agreements of long standing not infrequently break down during a depression, as happened when copper dropped to a world record low of five cents, and as has happened many times in steel, cement and other industries, making them for the time appear to be the most "flexible" of prices.

Centralized Financial Control and Centralized Government

The lessons of the ill-fated N. R. A. would have been worth the enormous cost if it had taught the business world that the vision of "self-governing industry" is a pipe dream. In a democracy, private monopoly cannot be left free to fix its own prices without eventual strict public control. Nor will private monopoly be free if it comes under a political dictatorship. Yet these are the alternatives to the acceptance, by business big and little, of the policy of free competition in free markets.

Who of us does not look with dread at the trend toward centralization of economic and political control in Washington? But the most strenuous protests come inconsistently from those in whose hands is already centralized a large share of the financial and price control of the nation's business. Which of these two kinds of centralization of power do the voters of the nation prefer, plutocratic or political control? The answer is plain: "neither". Free men instinctively fear, and rightly, that excessive centralization, whether of government or of business, threatens their happiness and their liberties. This is the dimly conscious thought back of the popular support of some measures in Washington that seem to many business leaders to be mere blind hostility to all business. Most American citizens are not hostile to the essential features of the capitalistic system. They do not look with favor on confiscation of private property or of profits fairly gained in fair competition; but they see private monopoly as a hateful thing.

The reattainment of free markets in America calls for a large measure of decentralization of financial control. It is not merely a matter of drastically enforcing the anti-trust laws. It may have to be that, but it must be more; it must go to the root of our whole corporate organization of business. The sooner so-called "big business" realizes this truth, the better for it and for all of us. If capitalism, with so much that is precious, is destroyed, monopolistic capitalists will be the destroyers. Real capitalism and private property, it must be remembered, imply a flexible price system in which freely adjusting prices serve constantly to determine the direction of investment and to reëstablish constantly a measure of equilibrium in the system. Centralization of price control and monopoly prices create all sorts of frictions and inequalities endangering the operation of the whole price mechanism. Already capitalism by recent changes has been converted into a complicated top-heavy financial organization better called corporationism It is a fair weather sailor, far less stable in a financial storm than was the simpler craft originally and still properly called capitalism.

If the defenders of big business claim credit for all the fruits of scientific research, higher education, and technical invention, they will have to assume the blame for the increasing demoralization of industrial depressions. The lesson of these recent years seems to be that our complicated corporationism has escaped from social control and has been allowed to pursue financial and material ends regardless of other values in our social life. Economic centralization entails the evil of greater centralized government. Economic decentralization is necessary if the largest possible measure of opportunity and economic independence is to be conserved and restored to our citizenry. I submit, therefore, that the restoration of fair competition will help not only to mitigate the severity of financial depressions, but to ensure the steady secular rise in the standard of living. More important, if we are to continue our progress on the road of civilization, economic freedom and political freedom must go forward hand in hand.

REMARKS BY THE CHAIRMAN

CHAIRMAN MITCHELL: The enviable task of opening the discussion upon these papers we have heard is entrusted to Professor Frederick C. Mills. Professor Mills!

DISCUSSION: THE PREREQUISITES OF RISING STANDARDS OF LIVING

FREDERICK C. MILLS
Professor of Economics, Columbia University

I THINK it is a very significant thing that "Prerequisites of Rising Standards of Living" has been selected as the topic of this meeting. I doubt that we would have thought it necessary, some years ago, to discuss such a topic. We looked upon rising standards of living as well-nigh inevitable, something of the nature of manifest destiny. This view, that progress is inevitable, has reasserted itself time and again in the history of thought. We find something of the sort in the views of Godwin and Condorcet a century or more ago in setting up the doctrine of the perfectibility of man. Later, in the theory of evolution, Spencer and Saleeby read the lesson that human institutions were bound to move on a constantly rising spiral toward perfection.

In more recent years it was the rising secular trend of living standards that we took for granted. We have assumed that there exists a persistent tendency toward higher living standards, that we are not called upon to take any positive action to insure that these standards should advance. But this somewhat naïve faith has been shaken in the last twenty years.

Some of the conditions of rising living standards have been discussed in the main papers that have been presented. It may be well to repeat a few simple facts. I should like to name certain conditions that are essential to rising living standards. These conditions are simple and obvious enough, and yet we are likely to forget them.

First of all, I would name the maintenance and improvement of the equipment used in production. This means, of course, advances in the technical arts. It means, further, the provision of new capital and the efficient use of existing capital. Perhaps the aimless and endless accumulation of capital is not the main requirement here. Invention tends in some degree to make tremendous additions to existing capital less necessary. We may invent a machine that is five times as efficient as the machine it displaces, and yet requires no larger capital investment.

A second condition, I would say, is the effective organization of the agents of production. I refer here to the job traditionally performed by the business man in bringing together the factors of production. Perhaps here lie some of the greatest of the difficulties we face today. There are difficulties in the way of the effective organization, in working units, of our productive agents. Some of these difficulties are of internal origin. The business enterprise today is a larger affair, it is more complex than formerly, and the tasks of administration and organization are more difficult to perform than they were fifty years ago. Within business units themselves there are difficulties in the way of efficiency that are characteristic of modern times.

Again, there is confusion today as to the limits of free enterprise. We have been going through a period of rapid change in the relations of government to business. As Dean Williams has said, it is perhaps not the fact of change but the suddenness of change that has created difficulty, that has left business uncertain as to the limits of the area within which it can act freely. The clearing up of confusion in regard to the relative spheres of private enterprise and government regulation will help to eliminate this difficulty.

There is doubt, also, as to the division of the field of enterprise between private initiative and government. Government is taking over some of the tasks formerly performed by private enterprise. This, perhaps, is inevitable, but it is unfortunate that confusion persists as to what the respective areas of operation are to be. One should note, too, that efficient instrumentalities of public action in the field of enterprise are yet to be developed. We are groping toward effective agencies through which government may operate in the fields traditionally exploited by private enterprise.

Further pressing problems arise out of changes in the status of labor. Labor is no longer hired under the conditions that prevailed fifty years ago. The task of the business organizer in bringing labor efficiently and harmoniously into a working enterprise is a difficult one, in the changing order of today.

In these obstacles to the free play of initiative we have some of the most serious barriers to rising living standards. The traditional rôle of business enterprise is being changed. We do not yet know what conditions may prevail in the future, and the uncertainties growing out of that situation serve to inhibit enterprise.

As a third condition of advancing welfare I would name the utilization of the principle of division of labor. This time-honored principle has been seriously impaired, in an international way, by the developments of the last twenty years. Some things may be said for economic nationalism in a troubled world, but one of its great disadvantages is clear for all men to see. Living standards the world over are lowered by the compartmentalizing of economic activity.

A major condition of high living standards is, of course, the economic allocation of productive resources. Obvious losses are incurred when these resources are used for purposes other than those related to advances in living standards. Wars and preparation for

wars engage a large part of the world's productive energies today. There is no hope for improved living standards in that direction.

In referring to means of making full use of productive resources I am constrained to say a word or two concerning Mr. Scoville's paper.

As Mr. Scoville was speaking the thought came to mind that perhaps a little humor is a dangerous thing. Mr. Scoville's paper was enlightening, but not altogether persuasive. I think he erred in dealing only with the long-run aspects of his problem. There are differences, and important differences, between the long-run aspects of technological improvement and the short-run aspects. In the long run technical innovations do, of course, raise living standards, but in the short run they may cause very serious dislocations in the working economy.

One of the greatest tasks we face today is that of adapting a complex economy to the rapid pace of technical change. This problem was completely ignored by Mr. Scoville. His picture of machines that might do all the work of mankind is a very happy one, but a question perhaps arises concerning the ownership of these machines and the division of their products. Professor Fetter pointed to this issue, I think, when he spoke of the necessity of assuring to the common man the fruits of technical progress. We miss the essence of this problem if we neglect all the readjustments between buyer and seller, employer and employee, borrower and lender, that are faced *in the short run* as a result of technological change.

As a final condition of advancing living standards I would name the efficient coördination of the elements of the working economy. This brings us to a phase of Professor Fetter's thesis, concerning the rôle of competition. The hidden hand of Adam Smith is perhaps somewhat palsied today, for reasons that Professor Fetter brought out, and yet the hand of conscious control is fumbling, too. We have no effective instruments that coördinate, that harmonize the complex parts of this economic system of ours, and one reason for the persistence of low standards of living today is that the parts of the economy as a whole are not geared together.

The long-term outlook today does not, I think, lead one confidently to expect an economic collapse, as some see it. The outlook, rather, is one of a world fumbling along at a low level of efficiency, with low standards of living. We have impaired the effectiveness of the principle of division of labor. We have, in some degree, impaired the effectiveness of capital. We have impaired the effectiveness of our instruments of coördination. Important productive resources are unemployed. We have diverted tremendous productive resources to non-economic ends. These conditions, if not remedied, mean the persistence of a low standard of living for men everywhere.

THE LABOR SITUATION AS A FACTOR IN BUSINESS RECOVERY

ISADOR LUBIN

United States Commissioner of Labor Statistics

As one reviews the literature of the business cycle, one finds a fairly general acceptance of the thesis that labor's part in recovery is restricted to making its contribution to the cutting of costs. The theory, put in its most simple terms, runs something like this: Prices fall, profits decline, production drops.

One important factor in the gamut of prices, namely, wages, tends, however, to lag behind the others. This lag, it is held, inhibits the decline in production costs to where profits become unavailable to the entrepreneur at existing price levels.

The problem of stimulating and hastening a revival, therefore, ultimately comes to resolve itself primarily into one of cutting wages.

Such an interpretation of the cost thesis is, to be sure, oversimplified. Other prices, such as freight rates, public utility rates, interest rates, and so forth, are also acknowledged as factors that impede such cost adjustments as are necessary to resuscitate profits.

By and large, however, the major emphasis is on wages. Indeed, one fairly eminent apostle of this school of economic thought stated only a little over two years ago at a meeting of the Economic Association that the revival of business activity after 1933 was definitely delayed by the relief policies of the federal government.

As he stated the case, had relief been denied to the unemployed, workers would have had to accept much lower wages in order to maintain their existence. Thus, costs could have been more adequately lowered, profit margins would have been greater, employment would have risen at a much faster rate, thus hastening the revival of industry.

Certainly no one will deny that changes in hours and wage rates are basically important in recovery. They affect directly the cost borne by competing employers, and the prices paid by consumers.

Wages are an important factor in competitive costs. The individual employer looks upon hours and wage rates as essential elements in his cost of production. To be sure, their importance varies from plant to plant and between different products. To the individual employer, however, in times like these, they appear to be among the most significant items in his competitive position, and hence, in determining his ability to maintain profitable operation.

When viewed from the standpoint of the industrial system as a whole, the wages of the employee group constitute a major fraction of the income of the nation. As such, they play an important part in determining the extent of the demand for the products of industry, and by the same token, for the products of the individual establishments which make up any given industry. Theoretically, of course, a horizontal decline in the price level of all factors that enter into production costs should have no effect upon the real income of workers. Looking at the problem realistically, however, the inflexibilities that prevail in different segments of the economy give little reason to assume that a decrease in wage rates, assuming that a general reduction could be secured over a wide field, would be either followed or accompanied by corresponding decreases in the price of the other factors of production. Consequently, with retail prices and the cost of living at the levels of the present moment, any wage reduction sufficiently large to affect the profit status of industry would tend, for the immediate future at least, to lower the real income of such workers as may be affected by wage reductions. In terms of industry as a whole, such wage reductions and the consequent obstruction to the distribution of income might possibly have a definite effect upon the output of their productive facilities in the sense that they might check the flow of goods into consumption channels. To be sure, lower wage rates might in certain instances be immediately reflected in lower prices to consumers, thus offsetting in part the lowered income of workers, but unless the combined costs of all other factors of production that enter into the final price were reduced proportionately to the decline in the cash income of the wage earners, they would not be in a position to buy as much as they formerly did. Concretely, a 20 per cent reduction in wage rates on a $10.00 article in which labor costs represent half of the total cost of production would aggregate $1.00, thus permitting its sale at $9.00. Such a decline, however, is equal to only a 10 per cent reduction in price as compared with a 20 per cent decline in the income of wage earners. Accordingly, the purchasing power is cut by 10 per cent.

Such a decline in the purchasing power of the wage earners might theoretically be offset, as far as the economy as a whole is concerned, if consumers other than wage earners increased their expenditures either through direct consumption or by investment sufficiently to offset the loss of wage earner purchases. But experience has shown that increased income in the non-wage earner classes does not necessarily bring with it a corresponding rise in expenditures for consumers' goods. Nor is it certain that an increase in investment would follow. Hoarding and a decline in investment might just as well follow, as was true during the period from 1929 to 1932.

Logic such as this does not resolve problems of the individual employer. The realization of the part played by the total income of the wage earner group in maintaining the proper functioning of the economy is of little solace to him when he must meet the competition of other producers or when bankruptcy is in the offing. Yet in terms of public policy the problem of wages as a factor in income and its flow through the economy is paramount.

Let us look at conditions during recent years, particularly those factors which have to do with labor costs. Taking up, first, the question of hours, we find that the average hours per week in manufacturing industries as a whole, as reported to the Bureau of Labor Statistics, were 37.9 in 1932, and 39.1 in 1936. They reached their peak in December 1936 when the average was 41.1. In March 1937 the average was 41.0 and in January 1938 the average was 33.2. In the non-manufacturing industries average weekly hours in 1932 ranged from 27 per week in bituminous coal to 52 per week in year-round hotels. In 1936 they ranged from 29 in bituminous coal to 48

in hotels. In nine instances the average was over 41 hours per week.

Average weekly hours in the individual industries are of course affected by various factors, such as volume of business activity, part-time, overtime and labor turnover. Accordingly, changes in average weekly hours do not portray changes in the length of the normally scheduled work week. They reflect, rather, the changes in actual operating conditions that result from orders received and from other factors that affect the ability of a firm to operate a given number of hours.

Average weekly hours were generally longer in 1936 in the durable goods industries. In the iron and steel group there were only three comparatively small industries—cast iron pipe, plumbers' supplies, and tin cans and other tinware—where weekly hours averaged less than 40. With the exception of electrical machinery and automobiles, virtually all of the other durable goods industries averaged more than 40 hours a week. In the non-durable goods group average hours were below 40 a week in 1936 in textiles and their products, in leather, and in tobacco. They were in excess of 40 in most of the industries classified in the food group. Cottonseed products, with an average of 49 hours, led in the number of hours worked per week.

In non-manufacturing, average weekly hours were above 40 in nine of the eighteen industries covered by the Bureau of Labor Statistics. These comprised metal mining, quarrying, electric light and power and manufactured gas, electric railroad and motor bus operation and maintenance, wholesale trade, retail trade, year-round hotels, laundries, and dyeing and cleaning. Among these industries weekly hours in year-round hotels averaged 48. In the operation and maintenance of electrical railways and buses the average was 46½ hours per week. The only four industries in the non-manufacturing group that averaged less than 40 hours in 1936 were anthracite mining, bituminous mining, crude petroleum, and telephone and telegraph.

In terms of the length of the working week and its effect upon the productive capacity of American industry it is significant to know that 44 per cent of the employees in the manufacturing industries covered by the Bureau of Labor

Statistics were in industries that averaged above 40 hours per week in 1936. Eighty-eight per cent of the employees in non-manufacturing activity were in industries where the average was above 40. Combining manufacturing and non-manufacturing, one finds that more than two thirds—69 per cent—of the workers were in industries averaging more than 40 hours a week. Moreover, it should be borne in mind that an average of 40 hours is in effect an actual operating week about 10 per cent in excess of that number of hours. Due to shut-downs, illnesses, absences, turnover and the like, the average plant, to average 40 hours for all of its employees, must operate about 44 hours.

It is quite evident that the past six years have not witnessed any marked reduction in the length of the work week. Indeed, throughout the period from January 1935 to March 1937 the trend of industrial activity brought with it a corresponding upward trend in the number of hours worked per week.

Taking up next the question of the earnings of workers, as they relate to costs, one finds that average hourly earnings in the manufacturing industries rose from 46.5 cents in 1932 to 57.5 cents in 1936. In 1937 they averaged 64.4 cents. It is significant that the increase in average hourly factory earnings between January 1934 and January 1937 was 6.7 cents, or approximately 11 per cent. The increase between January 1934 and January 1938 aggregated 13 cents per hour, or 24.2 per cent.

Breaking these averages down for the specific industries, one finds a range for the lower paid industries from an average of 22 cents in cottonseed crushing to 35 cents in fertilizers, and 42 cents in silk and rayon. In contrast, the average in the higher paid industries ranged from 74 cents in book and job printing to 87 cents in tires and tubes, and 92 cents in newspaper and periodical printing. Data are not available showing the relative levels of hourly earnings for the durable as distinguished from the non-durable goods industries in 1932. In 1936 there was a differential of almost 9 cents per hour in favor of the durable goods group, the average for the latter being 62 cents as compared with 53.1 cents for the non-durable industries. Despite this fact, a ranking of individual industries on the basis of hourly earnings shows that among the seven industries with the highest hourly earnings five were in the non-durable group. At the other end of the scale, the seven industries showing the lowest average earnings were also all in the non-durable group.

Although the figures of average hourly earnings present the best available evidence of the trend of wage rates, they do not serve as a really adequate measure of actual wage-rate changes. This is due to the fact that changes in the proportion of employed workers at a given wage level over a specific period of time affects the general average of earnings for all workers. Thus, prior to 1933, the general average of earnings was reduced in part by the fact that employment fell faster in the higher paid durable goods industries. During the years following, the relatively greater increase in employment in this group of industries played a part in increasing the general average. A case in point is the rise in employment in the automobile industry, which was much more marked between 1932 and 1936 than in manufacturing as a whole. During this period the number of employed automobile workers increased 88 per cent as compared with a 40 per cent rise in the remaining manufacturing industries. This relatively larger increase in employment in the more highly paid automobile industry affected the average earnings of factory workers as a whole. Accordingly, the rise in the average hourly earnings for the manufacturing industries cannot be attributed solely to rising wage rates. It was in part the result of the increase in the number of workers in the higher wage-rate industries.

It should be emphasized that we have been concerned thus far only with hourly earnings. As stated above, fluctuations in average hourly earnings are not an adequate reflection of the course of wage rates. It is virtually impossible to trace the course of wage rates as opposed to the course of hourly earnings. The reason lies in the fact that with relatively few exceptions, all of our important manufacturing industries employ the larger proportion of their workers on a piece work basis. The number of such piece rates is infinite. In a single rubber tire plant, for example, there are several thousand basic rates. Moreover, such rates are continually changing with changes in the nature of the processes and of the work to be done. Accordingly, any discussion of wage rates must be restricted to those relatively few industries where the large majority of workers are paid on a full-time basis.

In the few cases for which adequate wage-rate data are available, there is evidence of a wide divergence between the increase in average hourly earnings and the increase in wage rates between 1932 and 1937. In the much discussed case of building labor, the weighted index of hourly union wage scales for all building tradesmen, both journeymen and helpers, rose from 89.3 in 1932 to 98 in 1937, an increase of slightly less than 11 per cent. The index for 1937 was exactly where it had been ten years previous, in 1927, having risen from 98 in 1927 to 104 in 1930, and having fallen again to 98 in 1937. For journeymen workers, the index in 1937 was 97.6. Ten years previous, when building was booming, the index was 97.9. In the case of helpers and laborers, the index for 1937 was 101.5, or 11.4 per cent above 1932, a level slightly above that of 1929.[1]

In the unionized section of the printing trades the index of wage rates in book and job printing advanced from 101.4 in 1932 to 106.7 in 1937. In the newspaper branch the index rose from 101 to 107.[2] The weighted wage scale for organized truck drivers showed a rise from 72.2 cents in 1932 to 76.7 cents in 1937, an advance of less than 11 per cent. The weighted scale for organized street railway workers increased from 69.4 cents to 72.8 cents. In the organized bakeries the weighted index in 1937 was 92.8 cents, as compared with 95.1 cents five years earlier.

That the hourly earnings of American labor showed a marked rise in the past two years is obvious from all the existing statistical evidence. Such evidence does not, however, justify the conclusion that such increases are entirely attributable to changes in wage rates. To be sure, the widespread increase in rates was an important factor in affecting the level of earnings. Here it should also be pointed out that scheduled weekly hours of employment also played a significant rôle. This was particularly true in those instances where 40 hours

[1] *Monthly Labor Review*, Bureau of Labor Statistics, U. S. Department of Labor, Vol. 45, No. 5, November 1937, p. 1186.

[2] *Ibid.*, December 1937, p. 1512.

became the established work week and where prohibited overtime was payable for hours in excess of that number.

Nor does the evidence justify the assumption that such changes as did occur in the average hourly earnings of workers are an indication of what happened to labor costs. Union labor costs are a function of labor productivity as well as of wage rates. Productivity in turn is a function of the total output of industry and the total man-hours worked. Such rough approximations as are available show periods of appreciable fluctuation in unit labor costs in the face of relatively stable hourly earnings. Between 1934 and 1936, when average factory earnings rose by 2.7 cents per hour, or by approximately 5 per cent, the index of labor cost per unit of manufacturing output declined by slightly more than 3 per cent. During the latter half of 1934 when average earnings ranged from 55.3 cents to 56 cents, the index of unit labor costs varied from 113 to 121, reaching its peak in August, when earnings averaged 55.5 cents and ending the year (December) at 114, when earnings averaged 56 cents. Similarly, in 1935 and 1936 when earnings ranged between 56.4 and 59.4 cents per hour, the range in the index of unit labor costs was between 102 and 113.

In April 1937 when average hourly factory earnings were 63.8 cents the index of unit labor costs was at the same level as December 1934 when earnings averaged 56 cents and at approximately the same level as September 1935 when earnings averaged 56.3 cents. It is significant that the first marked increase in unit costs occurred in June and July of 1937 and that the rise between May and November was 26 per cent as compared with an advance in hourly earnings of less than 3 per cent. The rise for the year 1937 as a whole as compared with the year 1936 was 16 per cent, in contrast with a 12 per cent advance in the annual average of hourly earnings.

It should be apparent from the preceding data that factors other than wages and earnings play an important part in determining the course of unit labor costs. The evidence emphasizes the fact that such costs are frequently more seriously affected by fluctuations in total production, man-hours worked, and man-hour output. Accepting the hypothesis that the importance of wages as a factor in costs and the

HOURS, PAYROLLS, EARNINGS, PRODUCTION AND UNIT LABOR COSTS IN THE MANUFACTURING INDUSTRIES [1]

Year and Month	Average Weekly Hours	Index of Weekly Payrolls	Average Hourly Earnings	Index of Total Man-Hours	Index of Production	Index of Output Per Man-Hour	Index of Labor Costs Per Unit of Output
Average:			Cents				
1929	—	235.1	—	—	189	—	124
1932	37.9	100.0	46.5	100.0	100	100	100
1933	37.9	106.5	46.0	109.9	119	108	89
1934	34.7	135.6	54.8	115.4	124	107	109
1935	36.6	153.7	56.8	126.8	143	113	107
1936	39.1	177.6	57.5	144.8	167	115	106
1937	38.5	211.2	64.4	154.0	173	112	122
1936:							
January	37.3	159.1	57.3	130.4	151	116	105
February	37.4	158.8	57.1	131.0	148	113	107
March	38.6	167.2	57.2	136.6	154	113	109
April	38.7	170.9	57.3	138.9	167	120	102
May	39.2	174.1	57.4	141.8	167	118	104
June	39.2	174.8	57.5	142.3	167	117	105
July	38.5	172.8	57.2	141.4	167	118	103
August	39.4	180.0	57.1	148.4	168	113	107
September	38.7	180.2	56.9	148.9	170	114	106
October	40.5	191.8	57.4	157.8	175	111	110
November	40.6	195.5	57.9	158.4	183	116	107
December	41.1	205.2	59.4	162.4	181	111	113
1937:							
January	39.6	195.5	59.6	153.9	179	116	109
February	40.4	206.5	60.2	161.1	187	116	110
March	41.0	217.9	61.3	167.1	194	116	112
April	40.4	226.1	63.8	166.2	198	119	114
May	39.8	226.7	64.9	164.0	195	119	116
June	39.2	221.8	65.3	159.6	181	113	123
July	37.9	216.4	65.7	154.8	176	114	123
August	38.7	223.7	65.8	159.5	181	113	124
September	37.4	215.7	65.8	153.9	168	109	128
October	37.6	216.2	66.6	152.7	157	103	138
November	35.4	192.9	66.7	135.1	137	101	141
December	34.4	174.4	66.6	122.9	119	97	147

[1] See "Labor in Depression and Recovery, 1929 to 1937", by Witt Bowden, *Monthly Labor Review*, Bureau of Labor Statistics, United States Department of Labor, Vol. 45, No. 5, November 1937, for method of computation.

hypothesis that labor costs must be readjusted, the question arises as to whether wage reductions are the logical devices to employ in seeking a revival of industrial activity. There appears to be evidence to show that there are alternatives to wage cutting. How to bring these alternatives into being is a matter to be solved by the statesmanship of industry. In certain important industries the evidence seems to show that labor costs can be reduced by an amount in excess of what might be reasonably expected through wage cuts.

The problem resolves itself into the relationship between the volume of output and labor costs as such. As a concrete example, the steel industry might be cited. It is today operating at between 30 and 35 per cent of capacity. Based on the technology of 1934-1935, it would require 43.7 man-hours to produce a gross ton of finished steel products at the present rate of output. If the output were to rise to 60 per cent of capacity the number of man-hours that would be required to produce a gross ton of steel products would fall from 43.7 to 34.4. This is a decline of approximately 27 per cent. To realize a saving in labor cost equal to that amount would require a reduction of wages far in excess of what even the most rabid advocate of lower wages would suggest. It is estimated that if the industry returned to its production levels of early 1937 the actual number of man-hours required to produce a ton of steel would fall to a point where it would be about 35 per cent below requirements at today's level of output. Certainly no reasonable person would suggest that wage rates in the steel industry be cut by as much as 30 per cent. Yet there is a possibility of savings in labor costs in excess of that amount if the industry could attain the volume of two years ago.[8]

How to attain this greater volume and in the process enable labor costs to be cut to a degree far in excess of anything that could be reasonably expected through wage reductions is a matter which is beyond the confines of this paper. How far it would involve price cuts would be determined by the flexibility of the demand for steel. There are those who think that the demand is sufficiently flexible to permit the expectation of a

[8] "Man-Hours of Labor per Unit of Output in Steel Manufacture", *Monthly Labor Review*, Bureau of Labor Statistics, U. S. Department of Labor, Vol. 40, No. 5, May 1935.

stimulation of output sufficient to bring production up to the point where the industry can operate in excess of 50 per cent of capacity, if prices were reduced. There are others, however, who think differently.

In the housing field we have also heard a great deal about labor costs and the fact that we can expect a revival of building only when those costs are reduced. It is well to bear in mind that the extent of the savings possible through the wage approach is limited by the fact that labor on the site of housing construction constitutes approximately 34 per cent of the combined cost of labor and materials. Assuming that building wages were brought down to where they were in 1925, that is, reduced by 20 per cent, the net savings in total building costs at the site of construction would be less than 7 per cent. Such a saving would be equal to an 11 per cent decrease in the price of building materials. But are these the only alternatives?

Reputable builders testify that they can average savings far in excess of 7 per cent, the amount they could realize through a 20 per cent wage cut, if they could provide more regular employment to their workers. They contend that they could even offset in large measure the additional costs that result from certain union rules if the cause for the existence of such rules could be eliminated, namely, the irregularity, uncertainty and the temporary nature of employment in their industry.

These are but two instances where the alternatives have real potentialities, in terms of their effects on costs, equal at least to the effects that may be expected from wage reductions. Numerous other instances could be cited.

Considered from the viewpoint of public policy, may it not be better to concentrate on those features which may make for a lowering of labor costs far in excess of anything that can be hoped for from decreased wage rates?

In Memoriam

The Academy of Political Science records its profound sense of loss occasioned by the untimely death of S. Parker Gilbert on February 23, 1938. Although he had been a Trustee of the Academy and a member of the Finance Committee for only a short time, it has been our good fortune to have his wise counsel continuously since 1930. During these years he found time to assume constantly increasing responsibilities, rendering distinguished and unselfish service, for which the Academy is deeply grateful.

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MONOPOLY AND COMPETITION IN INDUSTRY AND LABOR

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
NOVEMBER 9, 1938

EDITED BY

JOHN A. KROUT

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PREFACE

At the moment when the Temporary National Economic Committee is beginning a comprehensive survey of American business management and ownership, it is particularly appropriate to publish this volume on " Monopoly and Competition in Industry and Labor ".

In the United States fear of monopoly has been perennial. It aroused hostility to the fiscal and economic policies of Alexander Hamilton and sent many voters into the ranks of the Jeffersonian Republicans. " Anti-monopoly " became an effective shibboleth of the Jacksonians, so effective that it was revived a generation later in the successful campaign for governmental regulation of business enterprise. More recently it has been a driving force behind the demand for enforcement of anti-trust legislation. The views presented in these pages may serve to delineate varying aspects of a challenging problem which has been often discussed with vehemence, but seldom defined with precision.

The papers here printed constitute the formal program of the Fifty-eighth Annual Meeting of the Academy of Political Science held at the Hotel Astor in New York City on November 9, 1938. The Academy is grateful to the speakers, who generously responded to the invitation to participate, and to the Committee on Program and Arrangements, the membership of which is here recorded: Robert M. MacIver (Chairman), Miss Ethel Warner (Director), Frank Altschul, Arthur A. Ballantine, Henry Bruere, W. Randolph Burgess, Nicholas Murray Butler, Frederic R. Coudert, F. Trubee Davison, Leon Fraser, Thomas W. Lamont, Roswell C. McCrea, Wesley C. Mitchell, Shepard Morgan, William L. Ransom, George A. Sloan, Gerard Swope, John H. Williams, Owen D. Young.

CONTENTS

PART I

MONOPOLISTIC TENDENCIES AND THEIR CONSEQUENCES

INTRODUCTION *

WESLEY C. MITCHELL, *Presiding*

Professor of Economics, Columbia University
Director, National Bureau of Economic Research
President of The Academy of Political Science

THE Academy of Political Science is opening its fifty-eighth annual meeting. No words of mine are required to emphasize the importance of the topic under consideration this morning, this afternoon and this evening: " Monopoly and Competition in Industry and Labor ".

The morning session is devoted to " Monopolistic Tendencies and Their Consequences ", a subject which will be discussed by a distinguished group of economists. It is no more necessary that I should occupy the time of this session by dilating upon the distinction of our several speakers, than it is that I should undertake to explain the importance of the topic; so, without more ado, let me introduce the first speaker, Professor John Maurice Clark, Professor of Economics, Columbia University, who will treat " Monopolistic Tendencies, Their Character and Consequences ". Professor Clark!

* Opening remarks at the First Session of the Annual Meeting.

MONOPOLISTIC TENDENCIES, THEIR CHARACTER AND CONSEQUENCES [1]

JOHN MAURICE CLARK
Professor of Economics, Columbia University

IT is obviously impossible, in a twenty-minute talk, to cover this huge subject adequately. I shall accordingly try, as Mr. Berle did in his much-discussed memorandum to certain members of the Temporary National Economic Committee, to achieve something of a perspective, and to say a few of the important things that seem to need saying.

In the first place, the conception of monopoly does not apply exclusively to large-scale business, nor exclusively to business as a whole. As the title of this series of meetings indicates, it is equally applicable in the field of labor. In fact, in proportion as labor-income absorbs a larger fraction of the consumer's dollar, in the aggregate, than capital-income (including net profits of business enterprise), it would logically appear that any monopolistic tendencies which may appear in the labor field are likely to be, by just that much, more important than similar tendencies in the field of business enterprise itself. It seems clear that in our official attitudes toward competition and toward restrictions on competition, we have a double standard, and are not applying the same tests to labor and to business. Different conditions may justify different policies; but it seems clear that any such double standard, if it is applied, should be required to square itself with underlying criteria which are not double, but are equal,

[1] It is an important principle that an economist speaking on a controversial subject should reveal any affiliations with interested parties. Having taken part in an N.R.A. study of the steel basing-point system, I was later engaged by the cement institute to take part in an impartial study of their basing-point system. As a sequel to this, I am now consulting with defense counsel in the Federal Trade Commission's pending complaint against the basing-point system in cement, with the understanding that my speaking and writing are entirely unrestricted.

If I did not conceive that I could still speak on the subject of monopolistic tendencies as impartially and objectively as an economist should, I should not speak at all. Whether I have succeeded, the audience must judge.

objective and impartial. I doubt very much whether our prevailing standards have been subjected adequately to any such objective and impartial criteria. The purchasing-power theory, applied to the doctrine of high wages, may be a partial answer, but only a partial one. The limits of its validity have not been determined with the hard-headedness which was once supposed to be the distinctive contribution of economists to such questions.

Another field in which monopolistic tendencies might well be studied is that of our greatest "natural monopoly": namely, government. What are the fields within which its monopoly position is properly exclusive, what are the limitations on its monopoly position, what are the proper fields of concurrent action by government and private agencies, and what are the standards of "fair competition" that should be set up in these areas of concurrent action? One could speculate long on these questions, did time permit. As to our forms of political competition for the control of government, it would be not only interesting but instructive to consider what would be the results if we were to apply to political contests some of the standards of fair competition which are being worked out in the field of business.

We have pure-food laws: what would happen if we applied standards of pure food for political thought, not to mention honest labeling of political proprietary remedies, or requirements that they be not labeled cures when they are in fact palliatives? What of pure fabrics for the texture of political measures, or of standards of truth in political advertising? What of the standard which says it is unfair competition to concentrate a discriminatory selling campaign in the limited area in which a small independent competitor operates? The attaching of premiums to the sale of a commodity is suspect; what of its political counterpart of irrelevant premiums, in the form of patronage or what not, attached to the sale of a political commodity? What of many other similar parallels?

I am not advocating radical measures in this field. Unfair competition and semi-monopolistic marketing advantages here will not be soon done away with. I merely mention it as a part of the general perspective within which we must try to see the more special problem of monopolistic tendencies in the field of business.

When "trusts" first became a problem, the foreground was occupied by the building up of great consolidated organizations, able to charge prices yielding high monopoly profits. They grew largely by methods of unfair and predatory competition by which smaller rivals were extinguished, the original Standard Oil Company standing as the typical case. With them went pooling agreements, also used to raise prices inordinately, though such unduly grasping policies brought their own punishment in the form of new enterprises which had to be included or bought up. With the coming of the United States Steel Corporation, the type shifted to price leadership, with "live and let live" forms of competition, and a tendency to stabilize prices at what the leaders of the market thought of as moderate and justifiable levels. Then came the growth of trade associations, tending to crystallize existing trade practices and to develop new ones; for example, open price systems, which are now on the border line of legality. Along with this went the classifying of dealers and the protection of customary dealers' margins.

Large single organizations did not cease to grow. There were mergers, stopping for the most part far short of the degree of unified control achieved by the original Standard Oil Company (the aluminum industry is a different type), but reducing the number of competing units and placing a few large ones in what we call a "dominant position"—whatever that may mean. Beyond the limits of corporate units lay a field of interlocking relationships of personal stock ownership, the effects of which remain to be adequately assessed. The problem today, however, centers in what we may call "imperfect competition" rather than outright monopoly; and this arises partly from the automatic effects of a reduced number of significant competitors, and partly from price leadership and various other trade practices, which do not extinguish competition but tend to canalize it into "live and let live" forms. This is the outstanding and distinctive feature of the present phase of the problem. Its immediate economic effects center in the protection of what business regards as a moderate and reasonable rate of return, and various degrees of stabilizing effect on prices.

There are, of course, other phases. Devices for limiting the scope and effect of competition display surprising variety and ingenuity, and some of them are carried on by governing bodies themselves. One might mention the following, as examples: (1) state government purchases limited to producers within the state; (2) milk inspection districts, set up in the interest of public health, but which have the effect of limiting the area which is allowed to serve a given city; (3) inspections and inspection fees on goods crossing state lines which are, in effect, discriminatory, though outright discriminatory fees would be unconstitutional in principle; (4) protection of the existing wasteful system of retail distribution against competitive cutting of margins, or against more efficient and more direct methods of selling, or more economical systems of mercantile distribution. Here a possible dilemma arises. It may be claimed that the independent retailer must be protected against the competition of the chain store, because otherwise the chain store will grow into a monopoly. This claim certainly deserves examination, but it should not be accepted as true without scrutiny. It would seem to be an open question which condition is more truly competitive: eight independent retailers competing in the old way, or two chain stores and three surviving independents who have been forced to adopt more efficient methods in order to survive. There may be unfair elements in this latter competition which should be removed; but if we protect the independent, not by removing unfairness but by laying discriminatory burdens on the chain store, I suggest that we should be clear as to what we are doing, and why. And I suggest that the force behind the drive for discriminatory measures against the chain store is not so much that it is monopolistic, as (a) that it is large, and (b) that its profits go to non-residents. In other words, the opposition embodies the principle of the local protective tariff, which is an anti-competitive principle. Possibly the opposition is justified when all effects are taken into account. I would not prejudge that question; but I would wish to get the issues clear.

Let us return to the general subject of imperfect competition as the characteristic modern form of the problem of monopoly. It is often thought to be something new, resulting from the recent growth of large-scale capitalistic industry. On this I beg leave to register a doubt. It is newly discovered by economic theorists, but that proves nothing.[1] Economic theorists are notorious (or deserve to be) for ignoring, or at least leaving out of their theoretical systems, facts which have been under their noses for generations. So far as it is a matter of the large size and small number of competitors, that is relative to the size of the market area. Four small producers in a small market area, limited by poor communications, might naturally be expected to show very similar results to four large producers in a large market area with good communications. As to the old-fashioned local grist mill or iron foundry or general store, it seems highly likely that, if the facts were fully known, they earned on the average higher rates of profits, and displayed on the average greater stability of prices, than the modern large corporation about whose imperfect competition we are so much concerned.

As to stability of prices, the recent writings of Mr. Gardiner Means have suggested a standard of judgment which appears to require very material modification before it can be used as a criterion to guide public policy. He has shown that prices fall roughly into two groups: one in which fluctuations of price are greater than fluctuations of output, and one in which they are less. But the former group consists for the most part of agricultural products, for which the demand does not fluctuate heavily from times of general business prosperity to times of depression. If we compare them with durable capital goods, the demand for which may fall off by one-half or two-thirds in a severe depression, it appears out of the question that the prices of the durable goods should fall by more than the output does. That would bring them far below cost, and bankrupt every producer. These prices should be flexible. There seems to be no good reason for questioning that conclusion, in an economy such as ours; but the standard of desirable flexibility remains to be worked out.

Yet after all doubtful propositions have been duly deflated, something substantial remains. It is probably true that imperfect competition, while not a new thing, is a problem of new and increasingly serious import for our present economic

[1] This, of course, is true only as concerns the attention paid to it. Cournot made beginnings at analysis of the problem a century ago, but they were long neglected.

society. It seems probable that this is true because our present economy is increasingly vulnerable to disturbances, and is more than ever before in need of all the competitive flexibility it can muster as a means of adjusting itself. The prospect of developing into an economy of stabilized prices and restricted output is probably a greater threat to true economic stability than it has ever been before. We used to say: " High profits are unjust, monopoly will slow down progress, more even distribution of incomes is desirable." Now we say: "Low profits and a more even distribution of incomes are probably necessary to make possible a free flow of goods and keep the system from falling into chronic paralysis and possible ultimate collapse." The matter is growing more urgent, and we cannot afford not to take it seriously. What should we do about it?

Our present policy is many-sided and admittedly far from unified. Some prices are thought to be too low and possibly too flexible, and we are trying to raise them. This applies to agricultural products and coal, with possible applications in the field of motor transport and elsewhere. Other prices are thought to be too high and too stable, mainly in the field of large-scale industry where imperfect competition is prominent, yet resale price-maintenance is also being promoted. Our double standard is not unified and brought into inner consistency by any adequate underlying criteria. Are such criteria available?

Do we want unrestricted competition everywhere? It seems clearly evident from our policy that we do not. Where unrestricted competition is most in evidence — and perhaps in some quarters where it is not — we are publicly promoting restriction. Elsewhere we are following the opposite policy. A rational unifying standard might be based on a very general conception of the kind of results that have been supposed to follow from " normal " competition. This is that prices tend, on the average of good and bad times, to cover the costs of a " representative firm ", including a return adequate to attract the requisite capital; and that they are flexible, being above this level in good times and below it in bad times. I shall not introduce here the refinements as to so-called " perfect competition ", elaborated by recent theorists; partly because their full implications for policy remain to be worked out.

The above result requires ideal conditions. Actually, unrestricted competition often drives prices below this level in good and bad times alike, while some forms of imperfect competition may push them above it, especially by limiting declines in bad times, and unduly restrict flexibility. But not all forms of imperfect competition necessarily work in this way. I have recently had occasion to analyze one proposed form of competition which clearly belonged in the " imperfect " class, and the natural tendency of which was to drive prices to a level which, while above " marginal " cost, in the sense of the added cost of added output to a plant with unused capacity, would be quite far below average cost. In other words, it would be a form of " cutthroat competition ". Some forms of imperfect competition can have this kind of result.

Moreover, the result depends, not simply on the form of competitive practices, but also on the underlying conditions of the industry itself. For example, it appears that the results of an open-price system may be to raise prices or to lower them, depending on the industry to which it is applied. Brands and differences of quality between competing producers are spoken of as elements of " partial monopoly ", yet if producers are few and large, the quality product may show on the whole healthier competitive conditions than the standardized product, since in the latter case a reduction of price by one producer is sure to be promptly met by his rivals. The producer comes to expect this, and competition in prices tends to a sort of stalemate.

Perfect competition is an impossible abstraction, and imperfect competition is inevitable, on account of the unavoidable characteristics of industrial production, regardless of the forms of trade practice within which actual competition is canalized; but, if due account is taken of the unavoidable conditions, the forms of trade practice may make a very important difference to the result. All these facts have a bearing on the choice of a policy.

The kind of policy which is indicated seems to be, not a laissez-faire acquiescence in any and all forms of trade practice which industry may evolve, and not an indiscriminate condemnation of all forms of canalized or restricted or " imperfect " competition, regardless of whether the competition

that is restricted is of the cutthroat variety or not. What seems to be called for is a realistic control of trade practices which should not simply prohibit unduly restrictive forms, but should assume constructive responsibility for working out for each industry, where unduly restrictive forms are found, the form which, in that industry, bids fair to give the nearest practicable approach to the results of " normal " competition. This should be done with as much coöperation as can be secured from the industry in question. It cannot be done by merely bombing at existing trade practices with negative " cease and desist " orders and letting the fragments fall where they may. Bombing may at times be necessary, but the rebuilding that follows is the more important thing.

And industry, on its side, if it realizes its own long-run interests, will have plenty of reason for coöperating, even to the point of loyally accepting and carrying out trade-practice rules which afford it less protection against so-called destructive competition than it now thinks it legitimately needs. Whether industry will be brought to realize all that this implies is, unfortunately, a doubtful question; but industry, like the rest of us, needs first and foremost an economic system that will go on working. It is becoming evident, not only that unduly stable prices tend to aggravate depressions, but also that there is a limit to the aggregate capital overhead which the industrial system as a whole can carry without being overloaded and ceasing to work. Not merely swollen rates of profits, but moderate rates on a swollen structure of genuine investment, may overload the system and bring about partial paralysis.

I believe, though I cannot prove, that capital must in the future adjust itself to a lower rate of return than it now considers reasonable, and to degrees of competition which it now considers unduly severe, or paralysis will follow, and capital will suffer along with all other interests. To put it the other way around, I believe, though I cannot prove, that if business gains the power, through imperfect competition or otherwise, to protect what it sincerely regards by customary standards as a moderate and fair rate of return, and is not restrained from exercising that power, the result is very likely to be economic suicide.

REMARKS BY THE CHAIRMAN

PRESIDENT MITCHELL: The second paper, "Monopolistic Practices and the Price Structure", will be presented by Dr. Edwin G. Nourse, Director of the Institute of Economics, Brookings Institution. Dr. Nourse!

MONOPOLISTIC PRACTICES AND THE PRICE STRUCTURE

EDWIN G. NOURSE
Director, Institute of Economics, Brookings Institution

I ASSUME that the topics of other speakers were, like my own, suggested to them by the Program Committee. Taken together, therefore, they may perhaps be looked upon as outlining the monopoly problem as the committee conceives it, giving a framework of hypothesis which individual speakers might attempt to support or to refute. The bones in this skeleton of thought include such words or phrases as big business, corporate policies, concentration, trade restraint, economic power, monopolistic practices, government regulation, proper control. The hypothesis which these words, used in the general topics and in the individual titles on the program, suggest to my mind would run something as follows. Modern industry by organizing in big business units, corporate in form, has taken on a distinctive new function of policy-making. These policies express themselves primarily in terms of prices, their effects are bad, and government must intervene more aggressively to protect the public interest.

Professor Clark's remarks began the process of putting flesh on these bare bones. I fully concur in his view that the problem we have to deal with is not outright monopoly but various forms of "imperfect competition", though I believe that "monopolistic competition" is a much better phrase to describe our present situation, in which elements of competition and elements of control are actively blended. I shall attempt to move the analysis one step forward by facing the question of what industrial management does with the power which it has to influence the prices of industrial products.

I am disposed to permit myself only two broad generalizations by way of answer to this query. On the basis of my studies in this field and my examination of those made by others, my first generalization would be that executives, upon finding themselves in the possession of a substantial measure of jurisdiction over prices, ordinarily act like human beings, with all the dumbness, all the cleverness, all the " cussedness ", and all the vision which that phrase implies. If I read the record correctly, they have shown themselves greedy, short-sighted, and naïve as to the nature of the economic process, and the rôle of price therein, to a degree which almost passes belief. On the other hand, there have been manifestations of farsightedness, business astuteness, and social consciousness which must command admiration and engender confidence.

As a slight elaboration of my first generalization, I might venture the thought that business men, turned loose in the rich field of price experimentation, have not only acted like human beings, but have acted like that particular species of the genus known as Americans. That is, they have displayed all the ingenuity which is supposed to distinguish our people. Rapidly and persistently, they have developed a great array of devices through which to apply such controls as they could acquire to such ends as they conceived to be desirable. Some of them have conceived pricing to be a mechanical process, with growth in size conferring proportionate power, which, through mechanisms as simple as Archimedes' lever, could be used to force prices up in some *pro tanto* relationship and maintain them at this level. Some have manifested a belief that pricing could be reduced to a simple cause and effect sequence and prices be made scientifically on a cost-plus basis that would guarantee profits. Others have approached pricing not as a science but as an art, in which success depended on the shrewdest intuition as to just what the traffic would bear and never taking less.

The devices, through which these general types of experimentation have been worked out, have given us a wide variety of monopolistic practices, such as classification of buyers, basing points, quantity discounts, zone or regional prices, base-and-surplus plans, market quotas, resale price maintenance, freight absorptions, advertising allowances, open price systems, and scores of others. To make these monopolistic practices at all manageable for a brief discussion, they must be grouped under a few heads. I shall speak of them, therefore, only in four categories widely used in discussions of the monopoly problem: namely, price leadership, sharing the market, price stabilization, and price discrimination.

No doubt you will be struck, as I have been, by the mildness of these terms. Three of them employ words of pleasing rather than sinister import. Leadership is the rôle of the hero and the pioneer, sharing is the act of the generous, and stabilization the hope of all of us in the turmoil of an unsettled world. Discrimination alone of these four monopolistic practices seems at first sound to carry a note of opprobrium; but in its other sense, a nice discrimination between price situations, and a dealing with each so as to evoke fully its constructive possibilities, is a thing for which society may well applaud the business executive rather than castigate him or seek to curb his actions. Let us look further, then, at the potentialities for both good and evil which reside in these four types of monopolistic practices.

Unquestionably we have ample evidence that corporate executives in a position of power have exercised price leadership to advance prices over any necessary relationship to cost, enjoying wide profit margins while " holding the umbrella " over smaller producers; but this is not the whole story of price leadership. Probably no one would deny that for some years back certain chain-store and mail-order concerns have exercised price leadership in the distribution field, with important results on manufactures. Has this leadership been directed toward higher prices or lower? Ford's price leadership in the automobile field and Firestone's in tires certainly meant lower prices. This individual dominion has now given place to a sort of rotating leadership, as large rivals have sought to outdo the pioneer leader in price reduction, quality improvement, and greater service to consumers. The steel industry under Big Steel's leadership long followed the Gary thesis of friendly competition, or " live and let live." But there are suggestions in the current picture that this " donkey race " may soon be transformed into a more sportsmanlike event, in which no jockeys " pull " their mounts. If the management of United States Steel decides that 60 per cent of capacity is not the point at which to throttle down operations by price advances, the public may soon be treated to a real test of just how cheaply steel can be supplied under conditions of capacity operation employing the most efficient techniques. This would turn the practice of price leadership in the steel industry to a constructive purpose similar to the socially useful kind of price leadership which has appeared in other important industries.

This brings us to the second great type of monopolistic practices, namely, price stabilization. We admit at once that reduction in the flexibility of the price structure may be a direct consequence of the acquisition of some degree of monopolistic control; but the motives dictating a course of price stabilization and the results flowing from different applications of the principle seem to be widely disparate. Thus, for example, prices may be held at a fixed level, volume of sales be permitted to adjust to this level, and scale of operations be promptly curtailed in step with any contracting of market absorption. On the other hand, we see a certain very strongly entrenched corporation starting from a policy of sustained use of plant and employment of labor, coupling this with a highly stable price schedule, accumulating large inventories during periods of slack buying, and feeding these reserves to the market when business is active. This raises the question whether, in an industrial society characterized by monopolistic competition, such practices might not be generalized to the point where they would constitute a preventive of cyclical swings beyond such as derive from seasonal, technological, or other adventitious changes. Might such an inflexibility of prices be more useful than price flexibility employed as a remedy for disturbances which had already attained considerable proportions—in part, at least, resulting from prices which had been pushed too high by unrestrained competition?

Our third type of monopolistic practices shows the same Janus-like character as its predecessors, facing toward both good and evil. I shall mention merely one—perhaps the most notorious—of the ways of sharing a market, namely, basing-point practices. This illustrates admirably the way in which monopolistic power may be used by relatively small groups to make themselves arbiters of a given phase of industrial development. The basing-point practice tends strongly to reserve the larger part of the market for concerns already established and to check decentralization of the industry or its migration to new centers of operation. The executives, who apply this practice, thus take on the character of economic planners within their particular sector of the economy. The question,

therefore, becomes one of how wise or socially desirable this *de facto* planning is.

The mere fact that basing-point pricing affords some protection to producers in one area, and somewhat retards development in another area, is not enough to damn the practice without reservation. The whole concept of social planning is based upon a similar principle, some restraint upon the process of economic expansion and migration being conceived as socially useful when it permits the orderly liquidation of old situations in step with the most sound and economical development of new ones. It may be remembered, for example, that in the early days, railroads used their monopolistic power to become the arbiters of our geographical expansion, with rate differentials in favor of the new area, regardless of its effect upon the functioning of the economic system in older areas. The long-and-short-haul clause in the Interstate Commerce Act was an expression of the view that this was not the best public policy.

Or, let us take a different type of illustration. Obviously, the strict and permanent adherence to " Pittsburgh-plus ", as a basing-point system, would be quite a different matter from what has actually worked out in this field, with new basing points added at seven times from 1921 to 1938, until there are now a total of forty-eight. No doubt this progress toward gradual liberalization of the pricing base has been due in considerable part to the impinging of technological and other competitive factors within the whole field of the metallurgical industries, and has been accelerated also by the proddings of public opinion. All this, however, is comprehended within the term monopolistic competition as we know it today. All that I am suggesing is that a considerable concentration of power and responsibility, even in private hands, may make, in greater or less degree, for that unified view of industrial strategy which takes on the character of true economic planning.

Finally, we come to the fourth category, price discrimination. This practice retains the evil smell of the worst phase of monopolistic predation, when rebates, price concessions and concealed favors created differentials in favor of the strong and powerful, or when price discrimination was the method by which the concern of great financial resources ruined its weaker rival as a preliminary to taking over his business or his territory. But this should not blind us to the fact that the power to adjust complicated price schedules may also permit of using price differentiations, essentially discriminatory in character, to expand the market, enhance the range of consumer satisfaction, and maintain or accelerate the tempo of business activity. Since the whole question of computation, imputation and allocation of costs is so much a matter of accounting technique swayed by personal predilections, the standard against which we measure prices to determine whether or not they are discriminatory as between commodities or groups of consumers is vague and shadowy in the extreme. The only point I wish to make is that executives endowed with a significant measure of price jurisdiction have a power, of which they have made interesting experimental uses in the direction of fitting the price structure to the income structure, so that the stratification of price, instead of creating advantages for the rich and powerful, has ministered to the needs of the poor and weak, to the stimulation of business and to the enlargement of the volume of employment.

In these hasty suggestions about issues of the widest import, I have simply tried to emphasize the fact that when the big corporate executive acquires a measure of price jurisdiction, he becomes a positive factor in the evolution of our economic system. While he works within the setting of great economic forces, their operation is by no means automatic in the sense contemplated by our theories of competitive price. The ways in which he uses this power and the devices which he develops for applying it will depend on his understanding of the nature of economic processes and how they work and on the objectives which he thinks it desirable to attain.

If anyone in this audience expected me to attempt to show a definite correlation between size, monopolistic position or given price practices, on the one hand, and the price relationships between commodities or classes of commodities — in a word, the price structure — on the other, he must by now be aware of how completely I have failed him. Because of the duality of basic price philosophies on the part of those who are endowed with price jurisdiction and the infinite shadings of intermediate positions, the nature of these relationships is bound to be indeterminate.

This leads me—in conclusion—to my second generalization. I see hope that the practices of monopolistic competition, as we know them today, are moving away from the deplorable state which obtained in the decade and a half before the World War and in the eighties of the preceding century, and toward a sounder, more enlightened and more constructive era. I base this hope — and a certain tempered confidence — upon three factors: (1) the sharpening of inter-commodity and even inter-industry competition through the technological possibilities created in a world of applied science; (2) the broadening and deepening of the economic wisdom of executives;[1] and (3) the very growth of large-scale business which confers on such concerns an institutional character whose wide range of interests and permanence of life emphasize the underlying harmony between great corporate interest and public welfare.

This process of development toward mature and sound use of monopolistic powers has not been completed. In view of the extreme youth of the big business movement, it is to be regarded as only in its beginnings. While monopolistic situations have been present in the economic life of man at least back to the time when Abraham and Lot divided the livestock business between Canaan and the valley of the Jordan, the problem of corporate concentration of power as we are considering it relates primarily to a period of only about fifty years. That is a relatively short time within which to work out the elaborate experiments and complex generalizations necessary to an understanding of what actions produce what results, of what in the broader economic and social sense will work and what will not.

But gradually the idea that price jurisdiction could and would be used primarily for the promotion of short-run acquisitive ends has been pushed into the background. This was not, I think, primarily because "original sin" disappeared from

[1] The lusty use of unaccustomed powers by early corporate executives to the single end of greatest personal acquisition over the short run have shown the limitations of such a policy. In a new generation, corporate executives are approaching their task with greater emphasis on professional skill and constant study as the prerequisite to the making of prices that "will work". They are concerned to erect a business structure that will stand up instead of falling down upon their own heads or the heads of their successors in office or, in its broader and longer consequences, the heads of their children.

the make-up of the business community, but largely because of growth in understanding. The bigger big business men, the more perspicacious or better educated business executives, are coming to perceive that, while such a course might promote the short-run interests of a business buccaneer, they definitely stand in the way of the comprehensive and continuing process of growth throughout the business system on which the deep and sustained prosperity of a system of free business enterprise must ultimately rest.

Just as the business situation is not characterized either by pure monopoly or by pure and perfect competition, so the practices of monopolistic competitors were not compounded of all of the darkest shades or of complete blackness in the days of the eighties or the decade around the turn of the century, nor have they come entirely to rosy hues or pure light today. But I do submit that a widespread type of corporate administration today, embracing men in the most progressive and respected executive positions, is turning its attention to ways of utilizing price jurisdiction which will build business broadly and soundly because making it contribute in the largest way to the service of society.

Arthur Burns, in his despairing and desperate book on *The Decline of Competition*, asserts that: "Competitive capitalism was given a protracted and thorough trial in the United States after the Civil War." In fact, two or even three decades are a very short period in the process of economic evolution. Only a superficial scratching of the possibilities in the use of competitive capitalism had taken place before the coming of the World War. Since 1920, a new and promising epoch of experimentation along quite different lines has been opening up. If the better possibilities of these newer devices of monopolistic competition are to be worked out to their full value and applied with the finesse which is necessary to promote the healthy functioning of a system of free enterprise, with only its necessary complement of government participation, much remains to be done. Instead of throwing up our hands in despair, professional executives and professional economists should join in the intensive study of the numerous constituent problems of this type of price-making.

Remarks by the Chairman

President Mitchell: The third paper on the program, "Corporate Price Policies as a Factor in the Recent Business Recession", will be presented by Sumner H. Slichter, Professor of Business Economics, Harvard University. Professor Slichter!

CORPORATE PRICE POLICIES AS A FACTOR IN THE RECENT BUSINESS RECESSION

SUMNER H. SLICHTER
Professor of Business Economics, Harvard University

I

IN analyzing the effect of corporate price policies upon the downturn of 1937, I shall consider three principal groups of prices: (1) retail; (2) capital goods; and (3) residential building. Attention will be focused in the main upon the period between May 1936, when the rise in raw materials began, and April 1937, when the drop in new orders commenced. To some extent, however, it will be important to examine price movements during the critical period between April 1937 and September 1937, when production was being maintained in the face of falling new orders by work on old orders.

II

The general level of prices paid by consumers is best indicated by indexes of the cost of living. Between May 1936 and April 1937, the cost of living, according to the National Industrial Conference Board, advanced 5.4 per cent.[1] This increase, though quite perceptible, was far from spectacular. The principal increases were in food prices (affected by the drought) which increased 7.0 per cent, and rents which increased 10.5 per cent.[2] Department store prices as a whole advanced 8.1 per cent between May 1936 and April 1937.[3] There were considerable differences in different groups—house

[1] The index of the Bureau of Labor Statistics, which appears at irregular intervals, rose slightly less—4 per cent between April 15, 1936 and March 15, 1937.

[2] According to the Bureau of Labor Statistics, the increase in rents was considerably less—only 3.5 per cent between April 15, 1936 and March 15, 1937. The National Industrial Conference Board figure is probably more accurate on this point.

[3] According to the Fairchild index.

furnishings advanced 6.7 per cent, women's apparel, 3.9 per cent, men's apparel, 2.7 per cent.

The increase in the retail prices was not excessive relative to raw materials, which increased 17.1 per cent between May 1936 and April 1937, to factory labor, which increased 11 per cent, or to finished goods at wholesale, which increased 8.6 per cent.[4] Furthermore, the rise in retail prices was substantially less than the increase in consumer incomes. Between May 1936 and April 1937, non-agricultural labor income (including relief and social security payments) increased 15.5 per cent and agricultural income even more. Despite the fact that consumer incomes were substantially outrunning retail prices, definite consumer resistance to higher prices started late in 1936. The New York Federal Reserve Bank index of distribution to consumers reached its peak of 99 in December 1936 and in January 1937. Thereafter it slowly dropped. By April 1937 it was down to 95. For six months thereafter it showed little change, rising in October 1937 to 97.[5] Thereafter it dropped sharply.

Just why consumers were so sensitive to higher prices is not clear, particularly in view of the rapid rise in consumer incomes. One explanation is that the thousands of men who returned to work in 1936 had debts to pay. Another one is that these men were uncertain how long their new jobs would last and so were unwilling to spend all of their pay. There can be no doubt, however, about the reality of consumer resistance. Retailers were well aware of it by the late winter of 1937, and, in placing orders for fall goods in the spring of 1937, they vigorously warned manufacturers that consumers would curtail buying rather than pay the increases which manufacturers were asking.[6]

[4] Of course, by April 1937, only part of the increases in raw materials and labor had been translated into retail prices because the goods on sale in April had been purchased before raw materials or labor had risen very far. This point, which is important, will be touched upon below.

[5] This, however, is a slightly misleading figure because it is affected by the large automobile purchases in anticipation of higher prices on 1938 models.

[6] Commenting on the consumer resistance to higher prices, the vice president of Gimbel Brothers said: "An alarming impasse has developed in retail trade during the last four to five weeks. Price resistance on the part of the

The full effect of consumer resistance to higher prices must always remain a mystery, because there is no way of discovering what would have happened if the resistance had not occurred. One possibility is that a larger volume of retail trade by strengthening the boom would have caused buying for inventories and replacements to develop into buying of capital goods based upon long-term planning. Such a recovery would undoubtedly have continued for a year or two without interruption. However, in view of the unsatisfactory outlook for profits even at the height of the boom (introduced by rapidly rising costs and an unpredictable labor situation), the mere absence of consumer resistance to higher retail prices alone would scarcely have caused the speculative boom to develop into a long-term recovery.

A second possibility is that, in the absence of consumer resistance, speculative buying in the winter and spring of 1937 would have been on a larger scale and would have lasted longer and that the ultimate collapse, coming perhaps several months later than it actually did, would have been more severe. Hence, the country can perhaps thank the consumers for offsetting the inflationary psychology of the business men and for nipping a dangerous speculative boom in the bud. Possibly the resistance of consumers to higher prices had more to do with controlling the boom than did either Reserve Bank policy or the drop in the federal deficit.

This reasoning is plausible and contains some truth. Nevertheless, I believe that it exaggerates the importance of consumers' resistance. The speculative collapse of April 1937 was world-wide. It began in London and was due to a reappraisal (1) of the supply of many commodities and (2) of the effect of the rearmament boom upon demand. It was influenced also by the favorable crop outlook. Had retail sales kept pace with consumer incomes in the United States, their dollar volume would have been about 8 per cent higher. Such

public has developed and clothing retailers who have announced higher prices can testify to this." *Annalist*, April 30, 1937, p. 682.

About the same date *Retailing* said: "Consumers have not yet seen higher prices comparable to the price upturn in the wholesale markets, it must be noted, but already there must have been some measure of resistance on their part. If there were not, say retailers, retail sales would not have receded below expectations during the past few weeks."

an increase would scarcely have averted the world-wide drop in raw material prices in April. Hence, although consumer resistance to higher prices undoubtedly helped to restrain the speculative boom, it was only one of many influences and the collapse of commodity prices would probably have occurred in April even had consumers not reduced their purchases. It is impossible to say whether, in the absence of consumer resistance, inventories plus goods on order would have been larger or smaller at the time of the speculative collapse.

Consumer resistance to higher prices probably exercised its greatest influence upon the general business situation immediately after the speculative collapse. The period between April and September 1937 was a critical one in which production was being sustained in large measure by work on old orders. The resumption of recovery, therefore, required that enterprises come into the market with new orders by the time work on old orders gave out. Had the absorption of goods by consumers between April and September been sufficient to reduce inventories substantially, a serious drop of production in the fall of 1937 might have been averted. Even had there been no further increase in prices after April, and even had consumer expenditures kept pace with consumer incomes, little or no reduction in retail inventories would have occurred. In order to reduce inventories sufficiently to pave the way for a large volume of new orders in the fall, retailers would have been compelled to make small cuts in prices. Here we see vividly the dislocating effects of the rapid increases in wholesale prices and wages during the previous fall and winter. Precisely when business stability required that retailers reduce inventories by cutting prices, they were paying steadily rising prices, because the wholesale prices of finished goods continued to advance until September. This rise does not seem to have been the result of monopolistic practices because it occurred in such highly competitive industries as men's and women's garments, shoes, and furniture. Rather it simply reflects the time required to pass on higher raw material and labor costs. At any rate, retail prices continued to rise until August, September and, in some cases, October — many months after consumer resistance had set in.

Perhaps manufacturers and retailers would have all fared better had they promptly taken losses on high-priced inventories in the summer of 1937. Their immediate losses would have been greater, but what enterprises would have lost in the summer of 1937, they would have recovered in better-sustained business in the following fall and winter. This is the kind of initiative, however, which the individual concern cannot afford to take, because it would be inviting a loss without exercising any appreciable effect upon the general business situation. Nor is there any reason for expecting that a government-planning and price-fixing agency would have ordered a general reduction in retail prices in the early summer of 1937, because at that time every one was expecting new orders to pick up in the fall. The remedy for the kind of trouble we experienced in 1937 apparently must be found in the discouragement of speculative forward buying.

III

Some students of business movements attribute the business collapse very largely to the drop in the orders for capital goods after April 1937, and ascribe this drop to the rise in the prices of capital goods between the summer of 1936 and April 1937. No satisfactory index of the prices of capital goods exists, but apparently the increase was about 15 per cent.

Certainly a larger demand for capital goods after April 1937 would have helped to prevent the growth of inventories and, therefore, to prevent a collapse of production in September. It seems clear, however, that the unsatisfactory demand for capital goods after April 1937 is not explained by the fact that industrial equipment cost about 15 per cent more than in the previous year. Enterprises plan their expenditures for new equipment in the light of the total business situation. This means that the demand for capital goods usually has an elasticity of less than one. If the business outlook is favorable, a 15 per cent rise in costs is not likely seriously to restrict expenditures. On the other hand, if the outlook is unfavorable, a 15 per cent drop in the price of capital goods is not likely to stimulate much new expenditure.[7] In fact, if it is true that the demand for capital goods is inelastic, then the increases in their prices late in 1936 and early in 1937 must have contributed to business recovery by increasing the total expenditures for capital goods and thus reducing the proportion of funds held in idle balances.

When one examines the causes for the sharp drop in orders in the demand for industrial equipment about April 1937, one finds several explanations which are more convincing than the fact that this equipment cost about 15 per cent more than in the preceding summer. The demand for capital goods in 1937 was almost entirely a replacement demand and was financed out of unexpended depreciation allowances rather than new issues. Indeed, only one dollar out of four spent for capital goods during this period was raised by new issues.[8] The fact that the demand was a replacement demand suggests that it was motivated partly by the desire to anticipate price increases. This means that it was quite limited in quantity and was bound to drop promptly if and when business men either ceased to fear price increases or had good reason for strengthening their cash position. It is significant that the sharp drop in new orders for industrial equipment began in April just after the collapse of commodity prices. The drop in commodity prices tended (1) to remove the fear of substantial further increases in prices, and (2) to arouse fears of losses of working capital among managers who had built up substantial inventories. Each of these effects might be counted upon to discourage business men from converting more working capital into deferred replacements. Consequently, the drop in the purchases of capital goods which had so much to do with bringing on

[7] On this point, a prominent maker of machine tools writes me as follows:

"Since the experiences of 1920 and 1921, in which an attempt was made by several machine tool builders to increase sales by lowering prices, it has been the general belief in our industry that this is a hopeless process, and it has not since been tried. There is a limited field of special built-to-order machinery in which at times there is keen competition on prices. While this keen competition keeps down the profit margin of these particular businesses, I doubt if it has any effect on the total quantity of such machinery made.

"Of course, there is some relation between the price of machine tools and sales. Any given proposal is ordinarily based on the length of time required to pay for the new investment with all the factors taken into account. ... This time has to be so short as to be attractive that it has to be an absurdly good proposition anyway, and 15 per cent on the investment one way or the other doesn't seriously handicap or seriously improve the proposal."

[8] Even had new issues throughout 1937 maintained the rate of the second quarter (the high quarter), they would have been only one-third as large in relation to the purchases of capital goods by business as in the period 1925-1929.

the depression is precisely the result which one would expect to follow from the collapse of commodity speculation. That collapse, rather than the higher prices of capital goods, must be regarded as the principal reason for the drop in the demand for capital goods.

The business situation early in 1937 was dangerous because a considerable volume of buying based on short-term expectations had grown up without stimulating buying based on long-term plans. Consequently, when the short-term outlook became unfavorable, there was no substantial cushion of long-term demand to mitigate the severity of the decline.[9] May not the failure of buying for replacement and inventories to develop into buying for long-term expansion be attributed to the rise in the prices of capital goods? The answer seems clearly to be "No". The demand for capital goods based upon long-term plans is governed by the long-term outlook for profits. Business men are greatly influenced in judging the outlook for profits by recent and present experience. The low level of demand based upon long-term plans in 1937 is most satisfactorily explained by the extraordinarily low level of profits even at the height of the boom. The profit situation in American industry is not accurately represented by the several hundred large corporations which publish quarterly returns. There are nearly 500,000 active corporations in the United States and there are over 1,730,000 employers making returns to the Treasury under the old-age pension tax.[10] These returns indicate that nearly three fifths of the employees and over half of the pay rolls are found in small concerns with less than 400 employees. In 1935, scarcely one out of three, and in 1936, less than half of the active corporations had any taxable income.[11] In 1936, total corporate income

[9] Contrast the situation in 1937 with that in 1921 and 1924. In each of those periods a substantial demand for capital goods based on long-term plans continued right through the depression and went far to limit its severity.

[10] The old-age provisions of the Social Security Act are estimated to cover about 60 per cent of the gainfully employed.

[11] The number with taxable income in 1936 was 203,162 out of 478,857. Even allowing for the fact that there may have been a few thousand financial corporations which had no taxable income, but had comfortable incomes from tax-exempt securities, the generalization holds good that as late as 1936 less than half of the active corporations of the country were making any money.

was only $3,928.5 millions, or less than four fifths the total of the depressed year of 1924 when the index of industrial production was 10 per cent below 1936![12] Unfortunately the Treasury figures on corporate earnings are not yet available for 1937. If we may assume that profits in general increased by the same percentages as did the earnings of the 168 companies reported by the New York Federal Reserve Bank, then corporate earnings during the first three quarters of 1937 were running at an annual rate slightly below the level of 1924. Furthermore, it must be remembered that the profits in both 1936 and 1937 were made possible (1) partly by inventory gains rather than operating margins (the result of the rapid rise in prices after May 1936) and (2) by forward buying which could not be expected to last. In the remarkably low level of profits even at the peak of the boom and in the fact that even these profits were in large measure the product of temporary conditions is found the principal explanation for the small volume of demand based upon long-term planning.

IV

A contributing cause to the general downturn in business in 1937 was the drop in residential building. The seasonally adjusted index of residential building, based upon contracts awarded, reached a peak in February. Private non-residential building, on the other hand, did not reach a peak until the third quarter. The downturn of the latter, therefore, was apparently a result rather than a cause of the recession.

[12] Prior to 1936 total corporate net income might be defined as statutory net income of income-reporting corporations minus the statutory deficit of no-income-reporting corporations minus the federal tax plus tax-exempt interest received by all reporting corporations. In 1924 this figure was $4,998.4 millions. The Revenue Act of 1936 imposed taxes on dividends received by corporations from domestic corporations. Under earlier revenue acts, all dividends received from such domestic corporations were exempt from the corporate income tax. In order to avoid double counting of income in 1936 (as well as to make comparisons with the returns of earlier years) it is necessary to deduct from the reported taxable income in 1936 dividends received from domestic corporations made taxable by the Act of 1936. When these corrections are made, the reported taxable income less deficits for 1936 is reduced from $7,321.9 millions to $4,643.5 millions. Deducting from this figure corporate income tax payments of $1,191.4 millions and adding $476.4 millions for tax-exempt interest received by the reporting corporations gives total net earnings of $3,928.5 millions.

The downturn in residential construction has been attributed to the rise in costs. Most of the indexes of building costs are not satisfactory because they do not take account of changes in construction methods or the efficiency of building labor and because they are based upon nominal wage rates rather than the rates actually paid.[13] The Boeckh index of building costs, however, is based upon the actual contractors' records.[14] Between July 1936 and June 1937, the Boeckh index for frame houses advanced from 86.8 to 98.2 or 13.4 per cent, and for brick houses from 93.1 to 104.8 or 12.5 per cent.

These increases in cost, while not spectacular, had a pronounced influence upon the demand for new housing. Residential construction contracts, after rising from about 25 per cent of the 1923-25 level in the first quarter of 1936, reached a plateau beginning with the third quarter of 1936. In that quarter the index stood at 45. The seasonally adjusted figures for the fourth quarter of 1936 and the first quarter of 1937 remained at about 45. Thereafter, the index dropped. In the third quarter of 1937, it was nearly 12 per cent below the first quarter and the actual volume of residential construction was 13 per cent below the third quarter of 1936.

For the sensitivity of the demand for housing to higher costs there are two principal explanations. One is that in the large cities a great part of residential construction is put up by speculative builders who expect to resell. A 10 per cent rise in costs naturally causes them to question their ability to pass on the increase to the buyer. Should they be unable to pass on a substantial part of the increase, their profits might easily be cut in two. Consequently, a relatively small advance in cost may cause speculative builders to curtail operations drastically. A second (and not inconsistent) explanation is suggested by the plateau in residential building beginning in

[13] There seems to be a considerable discrepancy between the nominal union rates and actual rates because many men work below the scale, particularly in the housing industry.

[14] The index gives the cost of constructing various types of structures. Prevailing wage rates are obtained from contractors. Actual rather than nominal rates for both skilled and common labor are used. An arbitrary labor efficiency correction is used, based on study of labor conditions in each area. Weights are based on studies of actual building costs and vary with the different types of structures.

the third quarter of 1936. This suggests that building was being sustained by a limited amount of urgent and inelastic demand. As time went on, the backlog of inelastic demand for housing gradually was worked off. If the volume of housing construction were to be sustained or to increase, this would have to be accomplished by satisfying a demand that was sensitive to prices. Just at this time, however, when the building industry needed the support of an elastic demand, building costs began to rise. The increase began in August 1936 and at first was quite moderate, but early in 1937 the Boeckh index was up about 6 per cent, and by June 1937, about 13 per cent.

The increase in building costs was particularly unfortunate because it came at a time when the housing industry was losing out in the competition for the consumer's dollar. The potential demand for housing is enormous because each year American consumers spend from $8,000,000,000 to $12,000,000,000 on durable consumers' goods including housing. In fact, consumers regularly spend from 50 per cent to 100 per cent more for durable goods than do all of the business enterprises of the country. Ever since 1926, however, the housing industry had been getting a smaller and smaller share of these expenditures. The reason is plain. In July 1936, the cost of frame houses was down only 13.4 per cent from the 1926-1929 average. Automobile prices, however, were 27 per cent below 1926, refrigerator prices, 58 per cent, radio prices, 50 per cent, and electric washing machines, 55 per cent. In 1926, one out of every three dollars spent by consumers for durable goods went to buy housing; in 1936, only one out of every seven dollars. The failure of the residential building industry to hold its own in competition with other durable goods industries is indicated in the accompanying table (p. 30).

Evidently the smart thing for the building industry to have done in the spring of 1937, after it had become evident that the backlog of inelastic demand for housing was being worked off and that the industry would have to be sustained by an elastic demand, would have been to cut building costs instead of raising them. Had the building industry been able to capture only one twentieth of the money spent by consumers on other durable consumers' goods, that would have been

	Construction costs single-family house		Prices of				Expenditures of consumers on		
	Frame	Brick	Automobiles [c]	Radios [d]	Refrigerators [d]	Electric washing machines [d]	Housing [e]	Automobiles [e]	Other durable consumers' goods [e]
								(in millions)	
1926	100 [a]	100 [a]	100	100	100	100	$4,314	$3,116	$5,360
1929			89.5	116.7	74.9	76.9	2,623	3,253	5,910
1936	86.6 [b]	93.1 [b]	72.7	50.0	42.1	44.9	1,200	2,496	4,600
1937	98.6 [b]	104.8 [b]	74.8	46.5	44.4	49.0	1,280	2,570	5,100

[a] Average for the years 1926-1929 equals 100.

[b] Figure for the month of July.

[c] The automobile indexes are based on the f.o.b. factory list of the cheapest four or five passenger closed model of each make and are weighted by the relative total number of new car registrations of each make. In view of the rapid improvement in automobiles it would perhaps be more satisfactory to base price quotations upon the price per horsepower. This fell from $24.4 in 1926 to $14.7 in 1929, $7.0 in 1936, and $7.5 in 1937.

[d] Prices were computed from figures for total volume and total retail value of the articles sold.

[e] Estimates of expenditures on durable consumers' goods are those of George Terborgh. The expenditures are expressed in dollars of 1929 purchasing power.

$385,000,000. This would have been the annual payment on a considerably large volume of housing. It would have made possible at least a doubling in the sales of housing in 1937 and the movement of large amounts of idle investment funds into housing. The building industry, however, is not well organized to market its product. Hence it is not able to practice smart marketing tactics in competition with the automobile and electrical equipment industries.

V

Among the more important general conclusions which stand out in this survey are:

(1) Business men made a major error in the fall of 1936 and winter of 1936 in overestimating consumer demand. They bid up the prices of raw materials and labor vigorously in the expectation that rising consumer incomes would permit the higher costs to be passed on. Consumer incomes did rise, but consumers did not behave as business men expected. They refused to take goods at the higher prices except in smaller quantities.

(2) The error of business men in judging markets first accentuated the boom and later tended to halt it.

(3) Although consumer resistance to higher prices contributed to the speculative collapse in the spring of 1937, it was only one of several influences. In the absence of consumer resistance, the speculative collapse would probably have occurred just about when it did.

(4) Consumer resistance to higher prices was an important obstacle to the reduction in inventories between April 1937 and September 1937, and tended, therefore, to accentuate the drop in production after September 1937.

(5) The drop in the demand for capital goods after April 1937 was not primarily attributable to the fact that they cost about 15 per cent more than in the summer of 1936. It was attributable to a combination of circumstances which made managements unwilling to use additional working capital for the purpose of making replacements of equipment.

(6) The rise in the prices of capital goods did influence the business situation by affecting the timing of the purchases of capital goods. The expectation of higher prices for indus-

trial equipment caused enterprises to anticipate their replacement needs. The forward buying of industrial equipment had the same effect as the forward buying of commodities. It accentuated the boom late in 1936 and early in 1937. It also accentuated the collapse, because concerns which had anticipated their requirements found less need to purchase subsequent to April 1937.

(7) The rise in the prices of capital goods was of no importance in preventing demand based upon short-term plans from generating demand based upon long-term plans because conditions for such a development were extremely unfavorable. If, on the other hand, conditions had been extremely favorable for the development of long-term demand, a 15 per cent increase in the price of capital goods probably would not have been a serious impediment. If, however, conditions for the generation of long-term demand had been neither extremely favorable nor extremely unfavorable, an advance of 15 per cent in the cost of capital goods might be an important impediment to the development of long-term demand.

(8) The advance in building costs late in 1936 and early in 1937 contributed to the downturn by reducing the volume of residential building. Residential building was sensitive to rising costs because speculative builders were doubtful of their ability to pass on higher costs, because the most urgent building needs had been met, and because the public was "cost conscious" and disposed to believe that it did not get a good bargain when it bought new housing.

(9) The drop in commercial and industrial building seems to have been mainly a result rather than a cause of the business downturn.

(10) The most important fact about the business situation in 1937 was that a high level of activity, based upon short-term expectations, failed to stimulate an expansion in demand based upon long-term plans. This meant that the situation of business was dangerous and that a sharp collapse might occur at any time. For this fundamental situation the movements of prices do not seem to have been responsible. A variety of conditions prevented short-term activity from generating long-term activity, but the principal one of them seems to have been the dangerously low level of profits even at the peak of the boom. Business managements were conservative in judging profit prospects because of the huge losses which many enterprises had suffered during the recent depression, because current profits in 1936 and 1937 were in substantial measure inventory profits, because the current volume of business activity was based upon forward buying and could not be expected to last, and because the rapid rise of labor costs was creating doubts concerning future profit margins.

Remarks by the Chairman

President Mitchell: The fourth paper on the program, dealing with "The Experience with Public Regulation and Public Monopoly Abroad", is to be presented by Oskar Morgenstern, until recently Professor of Economics in the University of Vienna, now of Princeton University. Professor Morgenstern!

THE EXPERIENCE WITH PUBLIC REGULATION AND PUBLIC MONOPOLY ABROAD

OSKAR MORGENSTERN
Princeton University
Formerly Professor of Economics, University of Vienna

THE topic which has been assigned to me for discussion is so large that I shall have to concentrate on a few points which—as I think can be shown—represent the essential elements of the experience with public monopoly and public regulation abroad. However, since this is a sketch with only a very few lines, it will look rather like a caricature, and I am afraid you will have the impression that I am drawing a caricature deliberately. That is not my intention. And yet, under some circumstances, it is indeed difficult not to write a satire. I should say that in this case it is virtually impossible to avoid being satirical.

Public monopoly is an old institution in Europe, but the oldest ones have primarily served—and indeed very successfully so—the purpose of taxation, as in the case of tobacco. Although they are very interesting from many points of view, they shall not concern us on this occasion. The other, later, types of monopoly were created to function as means of depression-policy with a view to stabilizing prices or production, and generally to stabilizing both. Their growth in recent years, and their great importance in the fields they cover, reflect the severity of the depressions which they are supposed to mitigate. The great fall in prices, accompanied by oversupply, caused the governments to hand over to newly created bodies the control of the respective markets. The commodities they deal with vary from the all-important grains to industrial alcohol, milk, rice, even watches; and they frequently wind up with the most powerful of all monopolies, namely, the dealings in foreign exchange. The foreign-exchange monopoly is a means of keeping the price of foreign currencies down at an arbitrary level or, inversely speaking, a means of keeping the value of the home currency arbitrarily high.

The administration of these monopolies usually lies in the hands of semi-independent, but government-controlled, bodies, and they are frequently supposed to stand on their own feet financially. Publicity, as a rule, is limited and is being more and more restricted where these bodies are not conspicuous successes. Indeed, in many cases it is almost impossible, at least for the public, to look through the fog which they very successfully create to conceal their manipulations. Not all these bodies conform with the rigid definitions of monopolies which economists would prefer to use. But there is no doubt that the monopolistic power which they exercise is so significant that these minor differences in their technical organization do not matter. In all cases these bodies have control of the market price which they can enforce with severe laws and consequent punishments. In so far as the rights of private property in these fields are not formally destroyed, they are at least restricted to such an extent as to make them often illusory.

There emerges from many examples one principal phenomenon. I am thinking of the fact that, once price control has set in, new controls of far-reaching scope and importance have to be piled up one above the other. It does not really matter whether the first step toward price-fixing was undertaken by a public monopoly or by some other governmental agency. All that matters is that the price laid down is not a market price, which after some adjustments and repercussions would balance production and demand. This is very elementary economics, and just because it is elementary it is also an indication of the tremendous dangers which must result from blunders in this field. The economist has little to learn from these events, but he has, regretfully, to realize over again that such economic policy can only rarely bear close examination.

The alternative with which all the monopolistic agencies were confronted, almost as soon as they had begun to take over the trading of the commodity in question at a fixed price, was either to discontinue their activity or else to restrict output. They invariably chose the latter way. Production, which was left in the hands of individual producers, would naturally expand as soon as it was evident that expansion was profitable. This inducement to increase production gained in strength during the period of falling prices. A farmer able to sell wheat to the grain monopoly would grow as much wheat as possible, if at the same time prices for his other produce fell, as they actually did. The monopoly, therefore, either had to buy excess quantities or control production, or set up a new, additional monopoly. In every case the fact emerges that a trading monopoly pledged to maintain prices, after a very short time, has no choice but to increase its scope at the cost of further suppression of private enterprise. This is precisely what has happened in every instance.

The public monopolies have been added to the formidable array of private monopolies and cartels which were supposedly effective means of stabilizing economic conditions during the business cycle. However, it should be borne in mind that they stabilized only prices, thereby inducing wide fluctuations in employment. Besides, the burden of price adjustment was thrown almost exclusively on that sector of the price system where competition remained active. This narrowing of the sphere of price adjustment is one of the fundamental characteristics of economic development in many European countries. The difficulties which the economic systems experienced in rising from the depression are frequently attributed to these developments, which were supported so strongly by government action, especially in the case of tariffs. It seems to me that this conclusion is unavoidable.

Now as for concrete examples! A very typical case was offered by the Milk Marketing Board in Austria. Originally set up solely in order to keep the price of milk from falling, the Board soon had to intervene actively in face of declining consumption caused by the general fall in income. The milk price had to be increased by a special levy, which was supposed to give sufficient funds to the Board in order to purchase the surplus milk, part of which after some time was to be distributed at a differential price to the needy and unemployed. However, output increased, the peasants being induced to keep more cows in view of the crisis in other agricultural products. Soon an increasingly large proportion of the total milk production had to be turned into cheese and butter, for which there was no outlet in the home market. Consequently both these products were exported at dumping prices and sold, for example, in England at about one sixth of the price to be obtained at home. The result was that the deficit of the Board piled up at an increasing rate. Finally, in order to stem the

oversupply, the number of cows which the larger estates might keep was restricted. The price of milk, however, was not reduced in spite of many serious efforts of the consumers, largely due to the fact that a part of the distributing machinery between the farmer and the consumer would have crumbled. This could not be tolerated because it was in the hands of numerous small people who could exercise enough powerful political pressure. Such was the experience with the milk regulation which had led to a complete impasse. Only a complete reversal of policy might have remedied the hopeless and absurd situation.

Much better still, let us consider the Czechoslovak grain monopoly. High tariffs and subsequent import quotas had caused the internal price of wheat to stand substantially higher than the world market price. The consequence was an increase of supply and lack of demand. A series of regulations providing for the obligatory use of a certain percentage of home-produced grain, and so forth, did not suffice, and finally (1932) a full-fledged monopoly, taking over all the internal as well as the foreign trade functions, was established. This monopoly had to regulate primarily the trading of wheat, the production of which increased while the cultivation of barley, rye and oats, where the price protection was much less, decreased. An enormous number of officials equipped with automobiles and motorcycles toured the country in order to supervise acreage limitation, which ensued, and to keep check on the mills with a view to preventing the milling and trading of wheat outside the monopoly. However, even the installation of meters at the mills, registering the amount of wheat actually milled, could not prevent the growth of a "bootleg market". Therefore, the decline in consumption shown by the statistics to have amounted to some 30-40 per cent was not entirely a real one. Meanwhile, the monopoly accumulated huge stocks, a great part of which decayed owing to bad, although expensive, storage. After the new harvest, this badly damaged wheat would be marketed while the newly stored began to deteriorate. A particularly curious device consisted of forcing the peasants in 1936 to repurchase some of the wheat formerly bought from them by the monopoly. There seemed to be no more logical way to dispose of the excess of wheat than this strange measure! The whole situation was changed profoundly only in 1937-38 when a general economic improvement occurred, largely due to a rise in world market prices and increase in armaments. The difference between the world market price and the home price amounted in 1929 to 31 ck. per q.; it had risen to 102 ck. in 1935 and fell in 1937-38. It seems to me that looking back at this experiment one would subscribe to the statement made in 1936 by Mr. Feierabend, then president of the monopoly: "The best means of regulation would most likely have been the free price."

Similar monopolistic regulations have been attempted in a number of countries, for example, in Italy, Holland, Switzerland, Jugoslavia. The technical differences are minor compared with the great general experience. All have had to proceed to further and more far-reaching intervention and all have come to a deadlock. In particular it must be asserted that there is no shade of proof that these monopolies have contributed in a positive manner to help overcome the depressions in the respective countries. Besides, they have imposed a heavy burden on the consumers, who had to pay for their follies, at a time when the decline in income was widespread.

One could go on to consider many more examples, if time permitted; and it would also be important to stress in each case the purely political implications of these monopolies. Only then would the full story be told. It seems, however, necessary to point to at least two more cases. There is first the money monopoly represented by the different kinds of exchange control. These systems function by giving a central agency the exclusive right to handle all dealings in foreign currencies. Originally an instrument for supervising capital movements only, it soon became all-inclusive, and no foreign-trade operation is possible, where this condition obtains, without the most detailed scrutiny and without approval of the central agency. This is identical with full control over imports and exports. Hundreds of thousands of employees work exclusively—in the larger countries—for this monopoly, which can only nominally keep the value of the home currency stable. The check on foreign trade, which currency control exercises, is greater than any hitherto experienced. This is now common knowledge, and even the countries having the strictest foreign exchange monopolies desire increasingly to get rid of them,

although there is, as yet, no evidence of a decisive change in policy.

Second, it is not surprising that public monopolies have even been incorporated in a whole new philosophy of the state. The idea of the "corporate state" expresses this glorification by forcefully creating hosts of "corporate bodies" which are nothing but obligatory cartels having the power to control new investments in their respective industries. The practical result is that they tend to eliminate every trace of new competition which might appear. They, therefore, deserve to be mentioned here, albeit they do not yet function in a very perfect manner, even in such countries as Italy where they are to be the very basis of the state.

To sum up: The experience with public monopolies, which were thought to be suitable instruments for stabilizing prices or production, has been most disappointing for the governments and the people. They are expensive for the consumer, they are exceedingly bureaucratic and they have to widen their scope and extend their interferences far beyond the field originally assigned to them. Their history shows fewer interesting features to the economist than their wide range might make one expect. They will always occupy, however, a prominent place in that great field of measures which might appropriately be called the "pathology of economic policy". Harsh as this opinion may seem, it is sufficiently supported by facts and analysis.

Remarks by the Chairman

President Mitchell: The fifth and concluding paper on the formal program, on "Methods of Developing a Proper Control of Big Business", is to be presented by Edward S. Mason, Professor of Economics, Harvard University. Professor Mason!

METHODS OF DEVELOPING A PROPER CONTROL OF BIG BUSINESS

EDWARD S. MASON
Professor of Economics, Harvard University

AN important first step in fixing the proper setting of this problem is to focus attention on the effects of large enterprise on the structure and functioning of the economy. A traditional attitude, on the other hand, has been to interpret the so-called monopoly problem in terms of the interests of particular groups. Consumers have been said to have an interest in free competition, while producers are concerned with the maintenance of fair competition. Whatever these terms mean, the establishment or preservation of free and fair competition is not an end in itself; it must be justified principally to the extent that it promotes an efficient, full and relatively stable use of human and material resources. Recent legislation in this field, however — I have in mind particularly the Robinson-Patman and Miller-Tydings Acts—continues to pursue the problem from the point of view of particular groups. Independent distributors are to be protected against the unfair or monopolistic practices of chain stores and other mass distributors without much regard to the effect of this protection on the functioning of the economy.

As soon as the problem is presented in terms of the relation of large size to the structure and functioning of the economy, three issues stand out as fundamentally important:

First, the consequences of corporate price policies for production and employment;
Second, the effects of restraints, in the well-known legal sense, on free enterprise and free bargaining;
Third, the consequences of the so-called concentration of economic control for the social stability of the economic system.

These three issues are not strictly independent. Corporate price policies *may* involve restraints of trade. It is quite possible that basing-point practices and other types of price formulae may be and should be held to be in restraint of trade. What should be realized, however, is that monopolistic price policies are not dependent on pricing techniques of a sort which might conceivably be held in restraint of trade. They are a product of the structure of industrial markets within which the size and number of firms are of leading importance. Likewise, the existence of monopolistic price policies and of restraints of trade may influence considerably the social stability of an economy in which economic control is concentrated. Despite the fact, however, that these issues crosshatch each other, it is important that they be visualized as distinct, both for purposes of analysis and for determination of possible remedies. Public policies which are likely to prove effective in handling one aspect of the problem may not prove effective in treating another.

The traditional area of anti-trust policy has been in connection with restraints on free enterprise and free bargaining. It is important, before proceeding further, to form an idea of what are the possibilities, but especially the limitations, of this type of policy in handling the problems of large-scale enterprise already mentioned. By common admission anti-trust enforcement has been until recently half-hearted and relatively ineffective. Even so, it has accomplished much. Cartel arrangements and practices which might easily have developed in this country, had the law concerning agreements in restraint of trade not been enforced, have been substantially prevented. Predatory competitive practices of large-scale concerns, furthermore, have evidently declined in frequency and importance, a result for which the existence of the anti-trust acts is, at least in part, responsible. Undoubtedly much more can be accomplished in this traditional area. The recent increase in the staff of the anti-trust division, procedural changes which are now in progress, and the imaginative and venturesome leadership which the division enjoys promise the most effective period of administration in the history of the acts.

Nevertheless—and this is the point to be emphasized—the limitations of this type of legislation in dealing with monopoly problems are real and serious. These limitations, it is true, do not apparently impress Mr. Arnold, the Assistant Attorney General. On more than one occasion he has declared it his belief that "Our ideal is already well stated in the Sherman Law. It only requires particular application." [1] The policy of the anti-trust division under his administration would appear to be gradually, by the continual pressure of particular cases, to expand the meaning of restraint of trade in the Sherman Act until it can be made to cover among other issues price and production policies of large enterprise. In a speech in October of this year he declared that

> The large organizations required today for efficient mass production have changed our conceptions of what is a reasonable restraint of trade. No one desires to break them up where they are efficient. Nevertheless, their very size gives them great control over the price structure even where that size is justified. Too often price policies of large organizations are not linked with the distribution of their productive capacity. Productive plants will be designed for ten years. Price policies will be aimed at attaining the maximum amount of the standard national purchasing power over a short period.[2] Great advertising costs, expensive and wasteful distribution systems, will be designed to take business away from others rather than to distribute more goods by lowering prices.[3]

No one will deny that an important problem is presented here. In fact — so far as the effective functioning of the economy is concerned—it may not be too much to say that it is *the* problem of large-scale enterprise. Whether it can be effectively handled by a reshaping of the anti-trust acts, or by any conceivable reinterpretation of the meaning of restraint of trade, however, is a different matter. The price and production policies complained of, and the shift in emphasis from price competition to other types of competition economically

[1] Thurman Arnold, "Fair and Effective Use of Present Antitrust Procedure". Speech delivered April 28, 1938 before the Trade and Commerce Bar Association of New York.

[2] Mr. Arnold was here concerned with price increases for industrial products which preceded the industrial downturn of 1937. These, however, were examples of price flexibility rather than the reverse. One of the problems of price behavior is concerned with corporate price policies which are "designed for ten years." Price policies which are adapted to the "short period" may be desirable. In a price system which was really flexible we should expect to see price increases in the upturn and price decreases in the downturn.

[3] "The Enforcement of the Sherman Act". Speech delivered in St. Louis, October 1, 1938.

and socially less desirable, rest fundamentally on certain technological facts which are not likely to be altered seriously by enforcement of the anti-trust acts. Among these facts are the increasing importance of durable capital and consumers' goods in the total output, an increase in the market importance of large sellers with the extension of mass production methods, a growth in the proportion of overhead to total costs in many industries, an increase in the number and importance of industries which have passed the stage of active competitive expansion. The implications of these facts are too well known to require elaboration.

One of the results is the well-established relative inflexibility of prices, during business upturns and downturns, of many industrial products accompanied by wide fluctuations in output, especially of durable goods. The extent of this inflexibility, however, is probably greatly exaggerated in consequence of serious limitations in the price data available for studies of inflexibility. Furthermore, recent investigations have indicated that it is not a new phenomenon.[4] Our capitalist economy has gone through several decades of expansion with continual increase in per capita production and consumption despite the fact of price inflexibility. This type of price behavior may not, then, be an insuperable obstacle to further progress and expansion. Nevertheless, admitting fully these comforting objections to the inflexibility thesis, there remains a serious problem. It may well be that a means of attaining greater flexibility would substantially promote a more stable and effective use of resources.

The inflexibilities that count are traceable directly to the price policies of large-scale enterprise. While these price policies frequently are associated with techniques which might be reached by a reinterpretation of the Sherman Act, they rest fundamentally on technological facts of the sort already mentioned. This does not mean that the anti-trust division should not press for such a reinterpretation or that the elimination of price control techniques is not important. Price leadership, uniformity of price bids, the practice of rotating

[4] *Cf.* Humphrey, D. D., "The Nature and Meaning of Rigid Prices, 1890-1933", *Journal of Political Economy*, vol. XLV, 1937, pp. 651-666; Mason, E. S., "Price Inflexibility", *Review of Economic Statistics*, May 1938, pp. 53-64.

the lowest bidder, are examples of techniques which might quite properly be held to be sufficient evidence of restraint of trade. Certainly the use of basing points and similar types of pricing formulae are practices which could be included in a more comprehensive meaning of restraint of trade. When and if the use of such pricing techniques has been eliminated by effective enforcement of the anti-trust acts, will the price structure or the behavior of industrial prices be seriously affected?

The answer to this question must be, in my opinion, "No". As long as the structure of industrial markets, including such factors as product durability and differentiation, number of sellers, the structure of costs and the age of the industry, remains as it is, there is overwhelming pressure on business management to pursue price stabilization policies and to divert competition away from price channels. Prosecution of the anti-trust acts may alter the structure of markets to some extent by breaking up firms and eliminating pricing techniques, but the scope of such action is distinctly limited. I should doubt, for example, whether successful prosecution of the aluminum suit followed by dissolution of the company would markedly affect the behavior of prices and production in the aluminum industry.

The moral of this is that, if corporate price and production policies are to be successfully regulated, it must be along some other line. The structure of certain markets, at least in limited areas, might be altered by the inclusion of more foreign competitors through tariff reductions. Other possibilities are present in the manipulation of government purchasing arrangements. The federal government is in the market on an increasingly important scale, and more intensive efforts on the part of such a large buyer to secure the benefit of price competition might make these benefits available to other buyers than government. In this connection it must not be forgotten that the activities of large enterprises as *buyers*, rather than sellers, are rather in the direction of price flexibility than of rigidity. If price flexibility is the *desideratum*, this end can be as effectively secured by the elimination of recent legislation as by the addition of new regulation.

It must be admitted, however, that these suggestions reveal limited possibilities. A thoroughgoing—not to say radical—

treatment of the price inflexibility problem probably depends on changing and controlling the incentives which govern price and production policy. A tax on the production of inflexibly priced goods during the upturn, a bounty on condition of price reduction during the downturn would strike at the roots of the problem. An even more drastic suggestion is associated with the application of A. A. A. techniques to the industrial problem. A tax on the production of industrial products to be remitted on condition of fulfillment of suggested production quotas would attack the question of idle resources directly rather than through changes in price behavior. Consideration, however, of the power and discretion which would have to be delegated to administrative agencies, together with the practical omniscience we should have to expect of such agencies, deprives these proposals of serious weight. However useful such techniques might be to a hierarchy of commissars they seem incompatible with the principles of democratic capitalism. The difficulties encountered by monetary policy in timing essentially similar action on a much less comprehensive scale fortify one's skepticism.

The fact of the matter seems to be that radical changes in the type of price structure and price behavior now associated with many industrial markets lie outside the scope of practicable public policy. It should be emphasized, however, that price inflexibility is less of a deterrent to an effective use of resources in a progressive, expanding economy than if that economy is stagnant or contracting. With the disappearance of free land and the cessation of rapid population growth the possibilities of expansion depend on holding open every door for technical change, new enterprises, new methods of production and distribution, and continued investment of capital. In a progressive economy the attempts of large enterprises to maintain their position by stabilizing prices and restricting output are doomed to be ineffective.

It is along this line that an active and imaginative enforcement of the anti-trust acts is likely to produce results, both in eliminating restraints within the scope of these acts and in laying bare other types of restraints which demand a different kind of action. A restrictive use of certain patents and the withholding of others from use entirely are examples of a different type of restraint which, if important, calls for a thoroughgoing overhauling of existing patent legislation. The present action of the anti-trust division against Chicago milk distributors has revealed the extent to which municipal sanitary regulations have been used to restrain freedom of entry into a market. These situations are best brought to light by the prosecution of particular cases. In the words of Mr. Arnold, "one function of anti-trust prosecution would be to capitalize and focus attention on economic conditions in particular industries which need adjustment." [5] Effective enforcement of the anti-trust acts is not likely to have much influence on price inflexibility but keeping the door open wide to free enterprise will definitely lessen the effect of such inflexibility on the efficient functioning of the economy.

In dealing with methods of developing a proper control of big business I have said nothing about direct governmental price control along public utility lines. Yet we are told repeatedly that the alternative to the monopolistic price policies of big business is government regulation of prices. The only method of government price control which has been extensively developed in this country is, as a matter of fact, the public utility type. To my mind the results have been extremely sad. No prices respond less readily to changes in costs, demand or general business conditions than public utility and railway rates. If we are to have direct governmental action in this field, government ownership or competition with private enterprise by public corporations offers, in my opinion, greater possibilities than the extension of public utility regulation.

Having touched, albeit inadequately, on the monopoly problem presented by corporate price policies and by restraints of free competition, let us turn finally to a consideration of the concentration of economic control. The existence of large-scale enterprise is only one aspect of this question. Its ramifications include such matters as corporate relations with financial institutions, interlocking directorates, and the existence of spheres of financial influence. Limiting ourselves, however, to the problems of large-scale enterprise the concentration of economic control presents, in addition to the issue of corporate

[5] "Policies of the Anti-Trust Division". Speech delivered September 3, 1938, at Convention Banquet of Independent Bankers Association, St. Paul.

price and production policies, a series of broader social questions relevant to what type of economic structure is compatible with the genius of our institutions.

Robert Jackson, former head of the anti-trust division, illuminated one aspect of this question when he said,

> This concentration of business accounts in large part for the lost influence of big business, and its press, and its legal lackeys, and its business organization, in legislation and election struggles. Forty years ago big business had as its ally in every town and settlement the local merchant, local manufacturer, local banker and local utility man. Each was a leading citizen, on whom many depended for information and leadership as well as for credit and jobs. This type of man has largely gone. Why he has gone makes little difference.
>
> In place of this strong and leading individual is a managing clerk at the chain store who cannot make a credit sale, and a local superintendent for the factory. The local bank is closed and nobody who has more authority than a bill collector represents the utility in most communities.
>
> The small business man who used to be our most ardent capitalist and the most uncompromising of conservatives has been crushed, or merged, or consolidated, or otherwise retired.[5]

The issues raised by Mr. Jackson have to do with changing social relationships between the business group, or one element of it, and other groups making up the community; laborers, consumers, farmers, investors and others. One question involves the extent to which these relationships have actually changed; another is concerned with the rôle of big business in producing such changes. Obviously these questions are too broad for adequate discussion here. I shall have to limit myself to two observations: (1) the extent to which the rise of big business during the last forty years is responsible for such changes as have occurred is usually grossly exaggerated; (2) changes in public policy directed toward these problems will have to be of a different sort and proceed from very different intellectual presuppositions than those underlying our traditional monopoly policies.

People who view with alarm the huge size of modern business enterprise and speculate upon its influence on traditional American democracy are apt so to speculate outside the context provided by the tremendous growth of national and busi-

[5] Robert H. Jackson, "Should the Antitrust Laws Be Revised?" Speech delivered September 17, 1937 before the Trade and Commerce Bar Association of New York.

ness wealth. It is true that the assets of a relatively few corporations constitute a large percentage of total business assets. But so did they forty and even fifty years ago. The change has not been nearly as great as it is commonly supposed.

Furthermore, for many aspects of the problem of concentration of economic control, total assets are a poor measure of corporate size. The number of employees is a very much better measure. Recent data published by the Social Security Board indicates that the relative importance—by this measure—of large-scale enterprise in the economy is much less than asset computations would indicate.[6] The ratio of assets to employees varies greatly from industry to industry and many firms which are colossal in terms of assets are of moderate size in terms of employees. This is conspicuously true of the utility field.

The fact of concentration has a real bearing on the character of the society in which we live. But is there not a disposition on the part of the "concentration experts" to idealize the American past as one in which men were free and equal and no group exercised more than its proportionate share of social influence? It is my impression that this ideal departs very far from the facts.

If the problem of concentration, in so far as it is represented by large-scale enterprise, is to be attacked by public policy, then the methods applied will have to be different from those associated with our traditional anti-monopoly policy. The objective becomes not the elimination of restraints or the curbing of monopolistic price and production policies, but an attack on size as such. The ideal envisaged is neither the maintenance of free enterprise nor a behavior of prices and production compatible with an efficient use of resources but, rather, a small enterprise economy. The method employed might be progressive taxation of corporation income, refusal to license corporations beyond a certain size for purposes of interstate trade, or many others. One's attitude toward this objective depends upon his evaluation of many factors which are impossible, in a limited time, to discuss. Among the most important are the possible loss in long-run efficiency, the costs of economic dislocation involved, and the probable changes in the locus and use of economic power. Without attempting to justify my position, I am strongly of the opinion that the advantages of such a policy are highly dubious while the costs are very real.

[6] *Cf.* Corson, John J., *Wages and Employment Under the Old-Age Insurance Program*, Social Security Board Release, October 3, 1938.

Remarks by the Chairman

President Mitchell: In accordance with its custom, the Academy will conduct a discussion from the floor. The discussion will be opened by Harry D. Gideonse, Professor of Economics, Barnard College, Columbia University. Professor Gideonse!

MONOPOLISTIC TENDENCIES AND THEIR CONSEQUENCES: DISCUSSION

HARRY D. GIDEONSE
Professor of Economics, Barnard College
Columbia University

I have been told that the discussion may roam widely, even if those who prepared formal papers are in the very nature of their enterprise restricted to a narrow and more specialized territory; and I propose to roam only for a few moments, for the obvious reason of limited time.

Monopoly has been dealt with here in rather scholarly and intellectual terms, but monopoly, of course, is a battleground in contemporary American politics and, as Professor Morgenstern suggested, in European politics.

A glance at the economic literature on monopoly in general makes it apparent that some of our best minds are splitting fine hairs when they might more fruitfully be splitting some of the dangerous logs that are clogging the flow of public and private business. We are tempted to draw elegant pictures with mathematical equations and graphs, while social and economic monstrosities of the sort described by Professor Morgenstern confront us in the day-by-day conduct of the public and private business of our time. While the more esoteric devotees of academic economics quarrel about fine points in the theory of imperfect competition, the Lower Economic Illiteracy attacks chain stores on the almost incredible ground that they are monopolies; at the same time the Higher Economic Illiteracy—including some of our " best minds " in politics and law—either advocates the organization of producers' monopolies, like these cartels we have been hearing about, as a sure method of increasing " purchasing power " in times of depression, or in the language of a nationally known professor of government, attacks " trust-busting as the blackest form of socialism ". The fact that other specialists in politics attack " trust-busting " as a futile return to laissez faire doesn't seem to give anyone cause for concern.

The attack on chain stores by the Lower Economic Illiteracy is based on the characteristic error of identifying mere size with monopoly, mere smallness with effective competition. It is very hard, as Professor Clark stressed, to be dogmatic with regard to the effect of

chain stores on consumers' interest. It is difficult to find out whether it is to the greater advantage of the consumer to be in a situation in which there are, shall we say, eight independents or two competing chains and three independents; but while we quarrel about such nice points, I submit that a certain amount of crude light can perhaps be thrown on the effect of the transition by just examining the nature of the lobby which in the various states is so busily engaged in legislating against chain stores. That, of course, is not a conclusive argument, either, but it throws some light upon the importance of some of the variables in the equations with which we are concerned. Typically chain stores have increased the standard of living of the American people by restoring competition in branches of retail distribution that had gradually settled down to more or less comfortable geographical monopolies. Legislation attacking or penalizing chain stores, therefore, tends to lower standards of living for the general public by increasing the margins which local monopolists can exploit with impunity. Essentially, it is legislation to protect small-scale local monopoly. Furthermore, it is designed to curb large-scale national competition. Politically, however, it is presented as part of the general attack on the monopoly problem. Laws of this sort, which are deliberately designed to increase the cost-of-living of the American public by reducing the effective force of competition, now exist in twenty different states and in more than fifty cities, and as a result of such legislation one of our largest grocery chains closed up 1200 branches last year.

The notion that the flow of purchasing power can be widened by monopolistic devices increasing costs-of-production, and the statement that " trust-busting is the blackest form of socialism ", are typical of the sort of economic views which the Higher Economic Illiteracy is now seeking to substitute for the much despised orthodoxy of the " classical economists ". Every one knows that if the shelves are crowded with unsold goods, it is not usually a good idea to increase prices if it is the purpose to clear the shelves. In national politics, however, monopolistic devices to arrive at " fair " prices or wages —which to a producer is likely to mean *higher* prices or wages—are the first resort of all the " practical " men involved in such efforts to upset the " theories of economists ". If there are men unemployed, it seems obvious that we can reduce unemployment by increasing wage rates. If the markets for our agricultural exports are destroyed by economic nationalism—which is a form of national monopoly—then our political doctors prescribe an increase in the prices of farm products by other monopolistic devices. If the productive capacity of our factories is largely idle, the obvious political prescription consists of agreements or cartels, which by price maintenance will further curtail the volume of production. If such schemes lead to reduced employment, higher prices and a lower standard of living, their "practical" and "realistic" sponsors will denounce the "folklore of capitalism" and illustrate a familiar principle in primitive psychology by pointing to economists and international bankers as the High Priests of Evil.

Perhaps the utter confusion in contemporary economic views is best illustrated by further analysis of the statement that "trust-busting is the blackest form of socialism". Socialism presumably means political monopoly. Trust-busting presumably means deliberate effort to restore control of production and consumption to the impersonal forces of a competitive market. The statement therefore boils down to the claim that an effort to restore competitive control by the open market is an effort to build up political monopoly. This statement that "wet is dry" comes from one of the most distinguished academic and public figures of our day as a fitting illustration of the chaos that now prevails in our public life.

Fundamentally, the drive toward monopoly in all ranges of modern life is due to our basic misconception of the nature of competition. Competitive standards are regarded—by producers—as unfair. Therefore, they coin phrases like "chiseler" and "scab" with which to color the consumer's reactions, although a chiseler, or a scab, is simply a producer who will sell or work at a rate the consumer can afford to pay. Producers are typically the active elements in our public life. Most of us are actively organized in our producer capacity, and inert and unorganized as consumers. Fundamentally, the issue is the old medieval one of "just" prices or "just" wages. Economists have rather conclusively demonstrated the futility of a notion of "just" price, that is not directly related to actual market forces on the side of both producers and consumers.

A price or wage might seem "just" or "fair" to producers, and yet not be within the reach of enough buyers to move the goods or to employ the available labor. It might seem "just" to the buyers, and yet not meet the costs of a sufficient number of producers to supply the demand. Why should we not consider a price as "just", if it is not fixed by collusion, and if it is a price at which no seller who is willing to accept it remains without a sale, and at which no buyer who is willing to pay it remains unsatisfied? In other words, why should we not assume an identity of *just* and of *market* price, if open competitive conditions are maintained? *

Vigorous exposition of the thesis that the notions of "justice" and of "open competition" are closely related is more urgently needed today, because of the relation of monopoly to the trend toward totalitarian government. Market price tends to enforce itself—as described in the preceding paragraph—through the impersonal force of adjustments by producers and consumers. Monopolistic price, however, requires specific and personal (or group) enforcement. Early experience with the N.R.A. immediately brought the issue of "compliance" to the foreground. Administration of the A.A.A., and its sequels, has made enforcement—particularly in the long run—a central issue. Trade unions that enforce rates above the market require the employment of devices that are politely described as "vigorous picketing", and less politely as "muscle men". Milk dealers who try to keep the prices of dairy products above the market have to resort to state trade barriers or to provide for informal enforcement along the highways when issues arise with so-called "scab" trucks. Any standard history of our large monopolistic corporations abounds with relevant illustrations. The notion of coercion—physical, legal or otherwise—is inherent in monopoly. Inherent in monopoly, therefore, is a trend toward dulling public sensitiveness toward the use and abuse of force—and ultimately toward preparation for acceptance of the view that public power to repress the exercise of coercion by private monopolists is a desirable if dangerous expedient. Here lies one of the most fascinating "no man's lands" in academic specialization—the relation between the growth of arbitrary power in politics on the one hand and the decline of the free market in economics on the other.

Here the general subject of monopoly and its consequences—our topic this morning—ties in with the future of the political institutions of a free and democratic society, as well as with the more obvious, more immediate and material concern for a full and productive use of our resources.

I conclude. If I have disappointed you by not paying more detailed attention to some of the more definite points advanced, I point to the clock and to the superior need for a bolder introduction of some of the larger aspects of the subject we have before us this morning.

* *Cf.* my paper on "Nationalist Collectivism and Charles A. Beard", [Jour]nal of Political Economy, Dec. 1935, pp. 778-799.

DISCUSSION: MONOPOLISTIC TENDENCIES AND THEIR CONSEQUENCES

CHAIRMAN MITCHELL: We are now ready for general discussion from the floor.

MR. CARROLL L. WILSON (Boston, Mass.): I have two questions to ask. I should like to ask Dr. Nourse the first one. Dr. Nourse, your advocacy of what you called dynamic price policy holds out an alluring prospect to people of free imagination; however, I wonder whether, in distinguishing, as you have done in your book on industrial price policies, and to some extent in your discussion this morning, between so-called dynamic pricing and monopolistic pricing, you have given too little weight to the difference in products that have been involved in these types of policy.

Let me frame the question in a different way. Do you know of any important instances, in which a producer of an old product was willing to continue a so-called dynamic policy of reducing his prices, when that policy meant a reduction in his total dollar sales?

DR. NOURSE: To the specific question, the answer would have to be no. I do not think I could cite a case of any producer in an established field such as you suggest, who knowingly and willingly has foregone profits at the level to which he has been accustomed. On the other hand, there are numerous instances where such reduction has been made in the expectation that it would expand volume and reduce unit costs of production so that profits would be maintained or even increased. There is a wide difference in situations, which we tried to emphasize in the industrial price policies book. We pointed out that the price reduction policy is one which ordinarily begins at the frontier of growth, where business makes contact with the ultimate consumer and, even along this frontier line, only at those points where technological advances are being made. But, starting there, with the action of concerns which are sellers to the consumer but buyers from other manufacturers, the influence is passed back and pressure exerted on many of the underlying groups, which forces them to make price concessions, thus causing the tendency toward price reduction—as a means of passing on to the consumer the benefits of technological advance—to infuse the whole system.

MR. WILSON: My second question I should like to direct to Professor Slichter. It is: Have you seen the later report of the returns of corporation income for the year 1936?

PROFESSOR SLICHTER: No.

MR. WILSON: Well, that has been published, since your article dealing with the low profits in the years 1936-37, and I am afraid that it will to some extent change your views, because the total reported profits of all corporations in the United States, less the deficits of those corporations, were larger in 1936 than in any of the years prior to 1928, and nearly as large as they were in 1928. That information has been published since your article first came out.[1]

PROFESSOR SLICHTER: That would indicate, then, the very interesting fact that the small concerns had done better between 1935 and 1936 in getting their costs under control than the large concerns. If we are reaching the point where the small concern can adjust itself to business changes as well as the large concern, that is a basis for considerable optimism, because the great disadvantage of the small concern has been its inability to afford a department for the making of changes. It has not been able to specialize on engineering and to organize itself for improving its methods and its products, at the same time that it continues routine production.

MR. WILSON: If the figures show, Professor Slichter, that the most spectacular changes between 1935 and 1936 were in the number of reported deficits, and in the reduction of the deficits of those corporations which in 1935 reported deficits, might that not be a result of the coming into the market of marginal concerns which had not been able to compete at all in 1935?

PROFESSOR SLICHTER: I suppose it was mainly the result, though it is dangerous to hazard a guess, of inventory profits during the spectacular rise in raw materials between May and December 1936. I hope that it is something more permanent than that, but I am very much afraid that it is simply a temporary favorable circumstance. For example, if one compares the profits of companies, which are doing about the same volume this year, with 1937, the results are not too reassuring. In that period, of course, the inventories played a somewhat opposite rôle.

MR. WILLIAM TOBIAS BUTLER: My idea of price is merely this, that price is affected by the fundamental conditions involved in our economic relationships, in our effort to serve one another in a free

[1] Professor Slichter has added the corporate income tax returns for 1936 in the printed report of his remarks. Observe that the actual increase in corporate income in 1936 was far less than the reported increase in taxable income because the 1936 law made intercorporate dividends subject to taxation. When correction for this change is made, corporate income in 1936 was even below the year of mild depression, 1924. On this point, see footnote 12 on p. 27.—ED.

market or in a monopolistic market, and that price will regulate itself, if there is a free market in which to exchange our services and in which the privilege to choose what we want remains. But beneath that action of serving one another, and permitting that service to have its influence upon price, free from any interference, I recognize the factor of a social function in those things which are non-competitive and which are serving the public uniformly and universally. Therefore, the factor of competition is not involved. I recognize this distinction, but, wherever competition is possible, the fundamental influence is the fact that we have introduced the corporation into the competitive principle and the free market. We have introduced an instrumentality, by its very nature unrestricted and unrestrained, which naturally has conquered the market by its size. No one in the United States can deny that that tremendous size commands resources and destroys the principle of individualism and the whole idea of competition and a free market. No man who buys goods in the various markets of our country expects to get a competitive price in fundamental fields.

You must face the fact that individualism is gone and the rights of the individual are gone. The American people have yet to decide whether the present efficiency of concentrated corporate organization is greater or more desirable than the social efficiency that comes from the initiative, from the energy, and from the enterprise of men who are eager to build careers in a competitive economic order.

CHAIRMAN MITCHELL: We have five minutes more at our disposal. Is there another question?

MR. HIGGINS: I wonder if anybody can explain what seems to me to be a change in the political approach to this problem of prices. As I recall it, the efforts of both the Hoover Administration and the succeeding administration, until recently, have been directed toward the maintenance of the price level by various devices. Now, the emphasis seems to be changing, and the effect of the present administration's approach is to break the price level down. If that is so, has anybody a reason for that different approach to the problem?

PROFESSOR MASON: I have no explanation of it. I will agree that there has been a change in what seems to be dominant administration policy, and I should say that it was conspicuously marked by the coming to the anti-trust division of Mr. Jackson. I have been a good deal impressed, in looking at the President's message on monopolies, with the similarity of the language to that of Mr. Jackson during the year. Why that has become important and is considered to be important now, I do not know, but I think that that is the stage at which it did become an important problem.

PART II

PUBLIC POLICY TOWARD CONCENTRATIONS OF ECONOMIC POWER

INTRODUCTION *

W. RANDOLPH BURGESS, *Presiding*
Vice-Chairman of the National City Bank of New York
Trustee of The Academy of Political Science

THIS afternoon continues the sessions, which began this morning, of the Fifty-eighth Annual Meeting of the Academy. The broad subject for the meeting is "Monopoly and Competition in Industry and Labor", and this morning a number of interesting papers developed the background of facts in this country as to monopolies and concentrations of economic power and their trends and consequences. In this afternoon's session the subject will be "Public Policy Toward Concentrations of Economic Power".

Let me remind you before the session begins, that the Academy, in its efforts to furnish a platform for the discussion of matters of public interest, wants to hear both sides of every case, not only from those whom it has invited to participate but also from any in the audience who care, afterwards, to take part in a general public discussion, which is by the nature of the case limited to a few minutes for each speaker.

The first speaker of the afternoon is one whose name is known to all of you, Mr. Thurman Arnold, formerly of New Haven, now of Washington, Assistant Attorney General of the United States. Mr. Arnold!

* Opening remarks at the Second Session of the Annual Meeting.

THE POLICY OF GOVERNMENT TOWARD BIG BUSINESS

THURMAN ARNOLD
Assistant Attorney General of the United States

SINCE I am forced to extemporize on the rather broad subject of the policy of government toward business, I am going to confine my remarks to the policy of my own shop, the Antitrust Division of the Department of Justice.

With respect to the enforcement of the Sherman Act, the policy of government toward business can be reduced to an easy formula on which we all would probably agree. The first part of that formula is this: None of us desire to abandon our traditional attitude of favoring an economy of free and independent business enterprise. I know of no significant movement in the United States which is attempting to depart from that ideal.

As evidence of this it may be noted that our most important investigation, by the Temporary National Economic Committee, is heralded an anti-monopoly investigation, even though the terms of the President's message cover a broad survey of our entire economy. The reason for the particular emphasis on "anti-monopoly" is that the word carries a picture of a state as we would like to see it. This attitude is the first element in forming the policy of government toward big business.

The second element in forming that policy is the fact that it is necessary to compromise between the logical extension of the anti-trust ideal and the fact that modern industrial techniques require large organization. I think no one desires to prevent efficient mass production and distribution. Therefore, wherever size or concerted action is necessary for efficiency in production and distribution, it may usually be supported by the famous rule of reason in the anti-trust law interpretation. There is a second necessary compromise or qualifying principle in the application of our competitive ideal. The complicated machinery of modern distribution requires certain concerted

action which must be justified under the principle of orderly marketing. Clearance in the moving picture industry and regulation of the spring surplus of milk are examples. Other illustrations are found in every large industry. A reasonable interpretation of the anti-trust laws must be one that does not wish to disturb either orderly marketing or efficient mass production. In applying these qualifications we must exercise care not to justify any larger combinations or any more restraints than are actually necessary. The burden of proof should always be against combinations which give great industrial power to small groups, but when that burden is met the Sherman Act should not be an instrument to promote inefficiency. This, I think, is the rule of reason in the anti-trust laws.

There are certain corollary principles in defining the policy of government toward business under these principles. Once it is decided that enormous concentrations are necessary in the interest of orderly marketing, or in the interest of mass production and distribution, there must be some public responsibility in forming the price policies of such great organizations. In other words, if a monopoly position is an economic necessity, public control of some sort or other must be sought. Competitive freedom from regulation cannot be extended where no actual competition can exist.

I think that if we face this fact, we shall find the areas in which monopolistic positions are necessary to be far more limited than we now suspect. We shall find, moreover, that competition in the great majority of industries is furthered, if we recognize the need of regulating necessary monopoly positions in a few. This idea is as old as our conception of public utilities.

These general formulas, I think, express the background of our tradition. It is almost impossible to define them concretely. Nevertheless, vague though they are, they are the best starting point to solve our economic problems without disturbing American traditions. The question is: How are we going to apply them? My answer is that the only way to do it is to take up one industry at a time. These ideals and principles give us not a chart or a plan, but an attitude and a picture of the society in which we desire to live. Their application to the unlike situations in different industries cannot be by general rule. It is a problem of organization, like the organization of an army. We must not first write the drill regulations and then make the army conform. We must train our companies and our regiments and then mold the drill regulations to their particular necessity. The necessity of taking up one industrial problem at a time is increased because after forty years without adequate anti-trust enforcement a number of eggs must be unscrambled. This cannot be done in the abstract. This must be done in such a way as to avoid unnecessary dislocations of interests which have clustered around excessive concentrations of wealth. Each particular industry, in that respect, presents a separate problem.

The problems of the building trades are not the problems of the movies; the solution of milk tells you nothing about the solution of concentration in cottonseed oil. If the basing-point system in steel is a system that we wish to get rid of, and if it be further true that getting rid of the basing-point system might destroy the economy of great cities, the method of accomplishing our objective must be examined with respect to its impact on the particular interests and individuals involved, and not by the logical development of a rule.

This seems a most difficult thing for the American people to understand, accustomed as they are to thinking that government by definition is the best government.

So much for the general objectives. What is a technique to accomplish them? I will illustrate it by outlining the technique of the instrumentality of which I am in charge—the anti-trust law. The Sherman Act, I admit, does not fill the entire picture. Nevertheless, it is our most outstanding expression of the ideal of free enterprise. It is also elastic and capable of developing practical methods of handling each industrial problem according to its separate facts.

There are two problems in this country today with respect to combinations which hamper or throttle independent enterprise. The first is a problem of prevention. The second is the problem of constructive solution of industrial areas and combinations which have gone so far toward control that they cannot suddenly be changed without something coming in to fill the vacuum.

The problem of prevention, I suspect, is everywhere. The Antitrust Division has never been adequately manned. In

the time of Theodore Roosevelt there were five attorneys. With such a personnel to administer such a vast undertaking, of course, that famous anti-trust campaign was a failure. Even at the beginning of the present administration there were only eighteen in the Division. This was a mere corporal's guard to police a country the size of America. Now there are ninety-seven. Yet this personnel has thirty-one major acts to enforce besides the anti-trust laws. It is obvious that if we are going anywhere in the actual problem of prevention of combinations, we must have regional offices and an adequate staff. I doubt if anybody has ever heard of the anti-trust law outside of a city of a million people and outside of our larger industries. If you don't believe it, look at the situation among smaller business combinations.

Our central problem is unused capacity. We have an income level which cannot absorb goods at the price level—65 per cent of the families under $1500 a year; twelve million families facing starvation, and so on. You are all familiar with those figures. I shall not go into them. They mean that business has become wedded to cost accounting systems which have put the prices above the possibilities of purchase under that income level. Distributors are not making any money. Merchants become discouraged. They turn to the chain stores and blame them for their troubles. They seek to tax the chain stores out of existence. Other industries seek to eliminate other competitors whom they call chiselers. States seek to abolish out-of-state competition, turning to their legislatures for aid. There is an epidemic of what amounts to protective tariffs between the states in the United States, not under that name, but under the name of inspection laws, or something equally euphonious.

The doctors are a typical example. With a scale of fees above what the community can pay for medical services, they are conscientiously and zealously, almost religiously, fighting organizations which are introducing competitive elements in medicine. The same influence is felt in almost every area of distribution. I believe that the anti-trust laws, the great preventive agency against the power of those who seek to eliminate competition, are the only force immediately available to turn this tide. Other legislation may be needed, but here, it seems to me, is the starting place.

I think that if respectable business men have their attention called to the anti-trust laws with a certain degree of firmness, the change will begin to be felt.

Today we lack men to handle the problem, yet I think it can be handled because I know of instance after instance of complaints sent to my office which I cannot investigate, yet where the slightest pressure would turn the trend and let competitors, who are now called chiselers, get their heads above water. So much for unaided enforcement.

When it comes to the larger industries of the country, mere prevention is often not enough; because, where size is essential to efficient mass production, a certain amount of power over prices is inevitable. In addition, larger industries are almost inevitably tied up with the smaller ones.

I was talking with some leaders in the heavy industries about the possibility of a concerted price drop in the housing industries, with the end of making this final product, the house, a little cheaper. No one, so they told me, can drop the price of his product for it will be absorbed elsewhere—in the contractor's profit, or in labor's reward—without cheapening the final product, the house. For example, we receive complaints from all over the United States charging contractors with clearing their contracts through joint agencies to eliminate competition. I was talking about the situation to one large manufacturer of a product important in building houses. He said, "I am at the mercy of these contractors. It is no use my reducing my prices."

It seems to me that the technique to meet that situation requires taking up all factors in the problem at once. If we prosecute a small contracting abuse in San Francisco, and later another contracting abuse in Boston, the total effect of our activity is negligible. If we take up the industry as a whole in twenty-five or thirty cities at the same time, we may say to the contractors: "We are trying to eliminate this price practice of everyone concerned at the same time, which prevents low-priced housing in large volume. You will benefit more than by your present policy of eliminating chiselers. We are putting the same pressure on the practice which prevents competition in the heavy industries so that you, alone, will not bear the whole burden."

We may say to the manufacturers: "If we can get from you a concerted drop in prices of all the elements which make up a house, we will protect you from the contractors ganging up and absorbing that drop."

At that point, I think, it is fair to ask labor to come in and promise them the same thing—a greater annual income for possibly a lessened hourly wage. I do not think it is fair to ask labor to come in first. Indeed, in such a situation you cannot get anyone to come in first. You are not going to get anywhere unless you take up the entire industry at one time. Further than that, I do not think you are going to get general principles out of the solution of one industrial problem, which can be applied by rule of thumb to other industries with dissimilar problems.

This technique of treating one industry at a time is possible under an intelligent application of the anti-trust laws. It means, however, that we must go further than mere prevention. We must develop the possibilities of the constructive solution of problems where enforcement alone is inadequate. We are trying to work out techniques by which we can get that constructive solution. Briefly they are these: By using the civil procedure as a method of going before a court to get approval of such voluntary plans, involving reasonable concerted action as will create orderly marketing and stop the violations. Where the anti-trust laws are completely inadequate, so that even the civil process used constructively fails, I think it becomes our duty then to present that inadequacy to the legislature. But in seeking legislation, as in seeking interpretation, I want to present one industrial problem at a time in the light of its peculiar facts.

I was interested in reading some of the comments upon the consent decree just entered in the Ford and Chrysler suit, criminal prosecutions which are an example of that technique. Ford and Chrysler, with the consent of the government, have submitted a set of practices involving concerted action to the court to decide on their reasonableness. These practices are not compulsory regulation of others. They are submitted only because Ford and Chrysler, having abandoned one way of doing business because they are charged with destroying competition, must substitute another to fill the vacuum. They are entitled to know whether the new way, since it involves concerted action, is reasonably designed to further competition. To inform a business organization of what it may voluntarily do without fear of prosecution is a real necessity.

The economic justification of advertising, at least in some industries, is the increase of consumption. For example, where you advertise particular brands of milk which have no special merit, you force your competitor, who furnishes the same product, either to spend an equivalent amount of advertising, and thus produce a wasteful system of distribution, or to go out of business. Ford and Chrysler have voluntarily agreed to eliminate such advertising in the auto finance field.

They agree to advertise a plan which will guarantee the cheapest financing for the public, the least expenditure. Chrysler agrees to advertise all those who will conform to that plan. The plan is subject to the objections of the Department of Justice or competing companies. In other words, the manufacturers are interested in getting cars out and not in favoring some particular finance company.

It was interesting to note that many newspapers interpreted the approval of concerted action on advertising, which bound only the parties concerned, as an attempt to regulate advertising. There is, of course, no desire to force business to take concerted action on advertising or anything else. However, where two great industries desire specific security from prosecution in adopting new practices, to fill the gap caused by the abandonment of old ones, it is only fair to submit these new practices to the court for approval, and to state why they are reasonable. This is not regulation of what business must do. It is clarification of what business may do.

This method has the merit of taking up one industrial problem at a time. If we take up unlike problems together, we get nonsense. For example, I can think of an amendment to the Copyright Law which might ameliorate a situation in the Association of Musical Composers and Publishers in which we have a suit in New York. I can also think of an amendment to the Copyright Law which might ameliorate a situation involving a combination of moving picture theaters in the Southwest to raise prices in second run theaters. But if you ask me to try to draw an amendment for both, the one that would work in one case would do incalculable damage in the

other. Therefore, in seeking ameliorations of business situations by amendment, my policy is: Clarify one situation at a time, and avoid the general, blanket sort of law which creates wreckage by trying to put everyone into exactly the same mold. I think that by applying that technique, we are going to get clarification of the anti-trust law, because the general formulas, (1) that we do not want to disturb efficient size, and (2) that we do not want to disturb orderly marketing practices, can only become concrete when applied to particular industrial problems.

I think we can make them concrete first by statements of what the Department is going to do—how the Department interprets the law (a most important aid to business men)—and second, by bringing enough cases into court so that guiding interpretations of the rule of reason may be found for each industry.

Clarification of the law will only come with enforcement; it will not precede enforcement. The different types of our industrial organizations do not permit anything more than the most general formula. We cannot get clarity by general definition. We can learn what the anti-trust law means with respect to milk, and with respect to medical services, and so on.

The conclusion, I think, of this brief talk, because I see my time is up, is simply this: If we are going to be sensible about creating a government which has a minimum of regulation, which is devoted to the ideal of free and independent enterprise, we must remember that organizations are more important that definitions. We will progress by taking up the problems of each organization under the general formula of our ideal, one at a time. It is because the anti-trust law, out of its historical background, offers a method of doing this that I hope it will become the central expression of government policy toward business.

Remarks by the Chairman

Chairman Burgess: We are very much obliged, Mr. Arnold, for that illuminating discussion. The next speaker is a good friend of the Academy. He has served on many Program Committees. He has served his term, also, in Washington, in various capacities, at one time as a member of a board to deal with labor problems in the automobile industry; but he is back now at Columbia as Professor of Economics. I have great pleasure in introducing Dr. Leo Wolman.

LABOR POLICIES AND THE VOLUME OF EMPLOYMENT

LEO WOLMAN
Professor of Economics, Columbia University

Most of us would probably agree that in a successful attack on the kind of unemployment which we have come to know in this country since 1930 lies the key to the solution of some of the most important and baffling of our current economic and political problems. So long as unemployment remains at its present high level, proposals to amend prevailing public policy are bound to encounter formidable opposition. The continuance of something like the present rate of unemployment will inevitably mean the continuance of at least the present rate of governmental expenditures. The longer public spending continues in something like its present amount, the more certainly will the conflict over the division of powers between local and central authority be resolved by transferring ever greater powers and responsibilities to the federal government.

Looked at in this way, current unemployment is by no means a simple labor problem. The methods devised to deal with it are certain to have far-reaching implications. For unemployment of this type, besides being a symptom of grave disorder in contemporary society, may, through the remedies applied to it, become self-perpetuating and for this reason the source of additional and still more serious disorders. If the current amount of public expenditures, and the mounting debt and rates of taxation associated with it, is indeed the crucial issue in economic policy that many students of fiscal measures deem it to be, then perhaps a correct analysis of the problem of unemployment may disclose the means of dealing simultaneously with both unemployment itself and with the problems to which accepted methods of treating it have given rise.

In such an analysis the first step is to obtain a more comprehensive description of unemployment than is now generally in use. This may be done most profitably by viewing current unemployment with some sense of perspective. Placed in its historical setting the unemployment which has prevailed in the United States since 1930, and more particularly since 1933, appears to reveal novel and striking features. The most crucial of these is the excessively high rate of unemployment that has persisted throughout our latest period of business recovery. Taken by itself this might be regarded as a purely fortuitous and temporary, though disturbing, phenomenon. But, judged in terms of the long-time rate of unemployment in this country and the appearance of the same phenomenon under similar conditions in foreign countries, the unusually high level of unemployment in American industry from 1933 to 1937 suggests unemployment in a new and unfamiliar guise.

This distinction between an old and new rate of unemployment is, perhaps, most clearly illustrated in the course of unemployment in Great Britain. For in that country it is possible to find a series showing the rate of unemployment, in reasonably reliable and comparable terms, from 1860 to date. For the 55 years from 1860 to 1914 the average unemployment rate, including periods of both good and bad business, was in Great Britain less than 4 per cent.[1] In only one year, 1879, did the rate exceed 10 per cent and then only by a small amount. During years of active business the rate was often 2 per cent and rarely exceeded 3. Since 1920, this picture has been totally transformed. Omitting years of severe depression, like 1921-22, and 1930-32, the post-war rate of unemployment in Great Britain, even throughout years of business recovery and general activity, has ascended to new and unprecedented heights. Thus in the seven years following the depression of 1921-22, the unemployment rate averaged 11 per cent, from four to five times the rate in similar periods before the War. During the latest period of recovery, 1933-37, the rate had risen to 15.3 per cent, or, if 1933 be omitted from this period, to 11.6 per cent, in either case materially

[1] The average annual rate of unemployment for the period, 1860-1914, was 3.4 per cent. This figure was obtained by averaging the annual rates of unemployment computed by Sir William H. Beveridge (*Unemployment: A Problem of Industry* [London, 1930], p. 39) for the period, 1860-1908, and the annual trade union percentages of unemployment (19th Abstract of Labour Statistics, Cmd. 3140, p. 78) for the period, 1909-1914.

higher than the rate of the 1920's and from four to seven times the pre-war rate. This, one must admit, is a startling development. Nor can it, in Great Britain, be regarded as a temporary one since it has persisted there for close to twenty years.

Equally good and comprehensive figures are unfortunately not available for the United States. But fragmentary data relating to the American unemployment rate suggest that our problem has become not essentially different from that of the British. Beginning here with the period since 1930 and computing our unemployment rate on a base much broader than the British and hence arriving at a rate apparently more favorable to this country than is warranted by all the facts, it is possible to derive a comprehensive rate of unemployment in this country for each of the years, 1930-38. During the four years, 1930-33, the percentage unemployed averaged 18.6 per cent, and varied from 7.9 per cent in 1930 to 25.1 in 1933. During the next four years of improving business, 1934-37, the rate averaged 17 per cent, and varied from 20.5 in 1934 to 13.2 per cent in 1937. If 1934 is omitted, the rate for the years 1935-37 becomes 15.9 per cent. Thus during this latest period of recovery it was found impossible to reduce the average rate of unemployment materially below the average level prevailing during unusually severe depression. If, moreover, the rate of unemployment during the four years, 1934-37, is compared with the rate during the seven years, 1923-29, the later rate is found to be more than four times the earlier, since the average annual rate of unemployment, 1923-29, derived by much the same general method, was something less than 4 per cent.[2] For the pre-war years no comparable series is available. But Douglas' figures, which begin in 1897 and which, because of their more limited coverage, probably show a higher rate of unemployment than a more comprehensive measure would yield, suggest that the pre-war rate in years of relatively active business probably did not often exceed 6 per cent. In the United States as in England, therefore, current

[2] *Recent Economic Changes*, National Bureau of Economic Research, 1929, vol. II, p. 478. The average annual rate of unemployment for the years, 1923-27, was 4.4 per cent. The unemployment rate for 1928 is assumed to be 3 per cent and, for 1929, it is computed by the National Industrial Conference Board (Conference Board *Bulletin*, July 30, 1938, vol. XII, No. 8, p. 64) to be 1 per cent. The average for the seven years, 1923-29, therefore, was 3.7 per cent.

unemployment appears to be distinguished from unemployment of the past by the persistence of an unusually high rate of unemployment and by the failure of the economic system to absorb, during a substantial part of the period of business recovery, all but a small percentage of the unemployed.

If this is a correct statement of the problem which this country now faces in the matter of its unemployment, analysis of the problem might most profitably concern itself with those elements of economic policy which are in the main peculiar to these more recent periods. While there are clearly numerous aspects of post-war economic developments which serve to differentiate the last twenty years from their predecessors and to account for some part of this observed increase in unemployment, it is in the general area of unemployment and labor policy that the most novel departures in theory and practice have taken place and it is there, consequently, that reliable clues to what is going on are most apt to be discovered. In support of these recent developments in unemployment and labor policy, there is, of course, a body of doctrine which daily becomes more elaborate and refined. But stripped of its refinements and elaborations, unemployment and labor policy as it is applied in this and other countries today possesses these plain and simple features. It is marked, first of all, by an intense preoccupation with nominal standards of employment and it is directed toward raising those standards in the shortest possible time. It involves, next, a thoroughgoing and practical redefinition of unemployment. And, finally, it looks to extraordinary public expenditures as, at the same time, the source of relief to the unemployed and an effective stimulus to business and, hence, employment. These diverse and, perhaps, discordant elements of the policy are conjoined and reconciled by their alleged separate and combined contribution to raising the country's purchasing power.

Estimating the effects of this and similar economic policies is clearly a formidable undertaking. For in economic science few of our conclusions rest on proof, in the accepted meaning of that term. In appraising the wisdom of alternative policies we are at the best forced to rely on the weight of available and relevant evidence and on a judgment of the situation which we derive from such evidence. Under the circumstances it is perhaps the safest rule in economic therapeutics to regard a

dose of policy, which fails in the appointed time to produce the expected results, as excessive and to reduce it forthwith.

Applying this rule of thumb to the several policies aimed directly at increasing employment and reducing unemployment in this country is bound to produce unexpected and weighty results. This is certainly so with respect to the most important standards of employment — wages and hours — whose correct manipulation has latterly been considered the most effective means of returning people to work. In the last ten years real rates of wages in several of the most important categories of labor have increased at a rate never before matched in this country during so short a space of time. It is probably correct to say that the amount of increase in these real wages since 1929 would, in the history of such movements, have required more than a quarter of a century to accomplish. There are many ways of recording these developments, but two sets of comparisons will adequately indicate the magnitude of more recent changes. Between 1914 and 1938 the real wage rates of factory, railroad and bituminous coal mining labor just about doubled. In building, the increase was 75 per cent but in these trades the rate of wages was already high relative to other industries in 1914. A very large portion of this increase occurred since 1929; for, from 1929 to 1938, the real wage rates of factory employees increased 45 per cent, of railroad labor, 38 per cent, and of bituminous coal miners, 50 per cent.

Much the same course has been followed in the reduction of the standard work-week and working day. In the fifty years since 1890, nearly all labor has enjoyed a progressive decline in hours of work, amounting to eighteen hours a week for factory employees and twenty-five hours for coal miners. Roughly one half of this aggregate reduction was, for these classes of labor, made since 1933. Only in building and rail transportation has the change in recent years been moderate. But on the railroads the adjustment of working rules has to some extent replaced consideration of the standard week, and in building average full-time hours were anyhow a fraction less than forty a week in 1938.[8]

[8] Leo Wolman, "Hours of Work in American Industry", *Bulletin* No. 71, National Bureau of Economic Research, November 27, 1938.

So far, then, as nominal standards of wages and hours are concerned, the advances since 1929 have been quite unprecedented. No one can look at them and feel that the policy applied to these standards has been a timid one or that its authors have erred in the direction of moderation. If in the face of such vast changes, unemployment stubbornly continues to resist this species of cure, it may be well to question the soundness of the diagnosis in which many of our economic practitioners appear to repose such profound confidence.

With the apparent failure of these measures to reduce unemployment to manageable proportions, the need for huge public expenditures has continued without abatement. In the process traditional views regarding public debt, the burdens of taxation, and the uses of public works as a means of regularizing employment have been abandoned. The policy of expanding and contracting expenditures for public works in relation to the successive phases of the business cycle, widely accepted in this country not so very long ago, has been thrown into the discard as both spending and debt have mounted to such levels that the variations about it have ceased to be nearly so important as the level itself. Moreover, public spending in its present amount has itself acted to sustain prevailing high standards of nominal wages and hours by effectively segregating the unemployed from the employed, by assisting in creating artificial and nominal standards of employment for both, and by impeding, thereby, the operations of a relatively free labor market.

Added to these factors, and indeed in great measure a part of them, have been the numerous and cumulative changes in the definition of employment and unemployment. In both Great Britain and the United States one of the most far-reaching developments in the organization and operation of the labor market has grown out of the exercise by a variety of public and quasi-public agencies of the authority to fix the terms of the employment contract. While this process has not yet gone so far in this country as in Great Britain, in the brief experience we have had with centralized relief, social insurance, the considerable body of labor law enacted since 1933, and the expanding control by organized labor, it has already made considerable headway in the United States as well. Under the influence of these changes, judgments and

decisions as to the availability and suitability of jobs are tending to be made not by the employee himself but by some governmental agent who is empowered to act more or less in his behalf. The total effect of such policy is, of course, still hard to estimate, but it is difficult to see how it can fail to affect the mobility of labor and the readiness of standards of employment to respond to changing business conditions, and through them the total prospects for employment.

Such in brief are the principal elements in current American labor policy. Right or wrong they have been applied with exceptional vigor and decision. While they are rarely considered in their entirety, they are in fact closely entwined and they are bound to stand or fall together. The effects they were intended to produce have not been realized. As they have acted in this country and as policies not essentially dissimilar have acted for a longer period in Great Britain, it is a mistake to look to this type of policy for a solution of the joint problems of unusual unemployment and heavy public spending. If, indeed, we plan to amend policy in the light of our experience with it, our records point to the need for a quick and thoroughgoing relaxation of many of the standards which we have put into effect in these last years.

Remarks by the Chairman

Chairman Burgess: Until a few weeks ago the next speaker was Under-secretary of the Treasury, in charge of taxation matters, a position which he held for more than a year. It has been a very busy position in recent months. He is Professor of Law at Columbia and will speak to us on the effects of taxation on corporate policies. Professor Roswell Magill!

EFFECTS OF TAXATION ON CORPORATE POLICIES

ROSWELL MAGILL
Former Under-Secretary of the Treasury
Professor of Law, Columbia University

THE impact of our various taxing systems upon individuals and business enterprises generally is a commonplace of modern life. It is not so generally appreciated that since our taxing systems are shot through with a considerable variety of special provisions, exemptions and exceptions, transactions or persons or organizations of rather similar character are frequently taxed differently. On the whole, the Congress has been concerned with the primary effect of these special provisions, exemptions and exceptions, in relieving a particular person or transaction from a burden deemed to be inequitable or undesirable; not with the possible secondary effects, of increasing *pro tanto* the tax burdens of others, or of driving them into new and different forms of enterprise. Moreover, because of the size and complexity of the revenue problem itself, for the most part the moving considerations in the formulation of tax laws have been purely fiscal considerations. Neither the administrative officials nor the legislators have spent much time considering the patterns of business or social conduct which were being fostered by the tax laws. Now that we have the basis of a quarter-century of experience with the modern federal tax system, the Academy may properly attempt some tentative conclusions as to the contribution made by the revenue laws in sanctioning or in discouraging particular business practices.

Since my limitations of time are severe, I shall deal primarily with statutory provisions which affect the size and character of corporate enterprise generally, not with provisions which encourage particular types of corporations, such as mutual investment companies [1] or building and loan associations.[2] For simplicity, I shall confine myself to the federal laws, and in particular to the income tax laws. This treatment is reasonably justified by the paramount importance of these laws as a factor in determining corporate policies. Because of the absence of reliable statistics at many points, my paper will be directed to the scope of federal regulation of corporate policies as expressed in the revenue laws, rather than to the actual results as demonstrated by changes in corporate structures, or in financial policies. Granted that many corporate subsidiaries have been dissolved in the past five years, it is difficult to prove that the dissolutions were attributable to the depression, to tax provisions, to mergers in order to effect business economies, or to a combination of these and other reasons. It *is* possible to describe accurately the contribution of the tax provisions to the general result.

The present federal revenue laws affect corporate practices in at least three major respects which are pertinent to this program. (1) The integration of separate enterprises into a single corporate unit is fully sanctioned, though there are troublesome conditions to be met. (2) The use of the holding company, whether personal or commercial, is discouraged, by heavier rates and by the denial of the privilege of filing consolidated returns. (3) Corporate capitalization and corporate fiscal policies are mildly directed by the capital stock tax, the undistributed profits tax, and the income tax provisions for a deduction for interest paid and for full taxation to individual stockholders of dividends.

I. The Form of the Business Unit

1. *Corporate Reorganizations—Mergers.* Confronted with a series of corporate reorganizations carried through without the benefit of specific statutory provisions, the Supreme Court held in 1921-25 that a stockholder realized income from the exchange of stock in a predecessor company for the stock of a new company or companies, organized to conduct the same enterprise with the same assets.[3] He also realized income

[1] In substance, a mutual investment company, as defined in Supplement Q of the Revenue Act of 1938, is taxable only upon that portion of its adjusted net income which is not distributed to its shareholders.

[2] "Domestic building and loan associations substantially all the business of which is confined to making loans to members" are exempt from the federal income tax. Sec. 101, Rev. Act of 1938.

[3] *Cullinan v. Walker*, 262 U. S. 134 (1923); *Marr v. United States*, 268 U. S. 536 (1925); *cf. Weiss v. Stearn*, 265 U. S. 242 (1924).

from the receipt of shares in a new company in which had been segregated part of the business of the old.[4] In each case, the stockholder had received an interest different in kind from what he had had before—shares of stock in a new and legally distinct entity. In the cases in which the old company remained in existence, and the stockholder received shares in a new company as a dividend, the surplus of the old company was in fact large enough to cover the distribution. It is of course possible to realize income in property as well as in money. Hence the court was justified on purely legal grounds in deciding that the year of the receipt of the new securities was an appropriate time for the computation and taxation of any profit which had accumulated in the investment.[5] At the same time, the decisions turn largely on matters of legal form, and hence the distinctions are not appealing to a layman or to an economist. Either finds it hard to see an occasion for an income tax when there has been no substantial change in the original investment,[6] but merely the organization of the DuPont Company of Delaware to conduct a part of the business of the DuPont Company of New Jersey.

Viewed merely as instruments of tax policy, then, these decisions were bound to be challenged. Moreover, in the early twenties, Congress regarded business reorganizations as frequently desirable and often necessary. Hence, successive revenue laws contained increasingly liberal provisions, to permit corporations and stockholders to carry through tax free, not only the kinds of reorganizations which the Supreme Court had passed upon, but a number of other kinds. These provisions, among the most complicated in the law, began to appear in 1918,[7] and reached their zenith in 1924.[8] Since 1934, Congressional doubts of the wisdom of the policy have

[4] *United States v. Phellis*, 257 U. S. 156 (1921); *Rockefeller v. United States*, 257 U. S. 176 (1921).

[5] See Magill, *Taxable Income* (1936), pp. 52 *et seq.*

[6] Some economists, notably Robert Murray Haig, have defined income as "the money value of the net accretion to economic power between two points of time." Although Dr. Haig might favor an *annual* accounting for this increase in value of assets, *quere* whether he would choose the time of a corporate reorganization as the occasion for such an accounting.

[7] Sec. 202(b), Rev. Act of 1918.

[8] Sec. 202, 203, 204, Rev. Act of 1924.

brought about a gradual attrition,[9] but the core remains; and even as late as 1938, additions were made at the request of the Securities and Exchange Commission for the benefit of public utility companies compelled to reorganize under the Public Utility Holding Company Act of 1935.[10]

It is hopeless to attempt to treat in more than the most general outline a series of provisions upon which books have been written,[11] but a summary of them will enable us to detect and to evaluate major policies.

The definition of reorganizations in the act[12] commences with statutory mergers or consolidations; that is, mergers or consolidations carried out under the applicable state laws. The definition proceeds with "the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation." It comprehends also "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred." This comprehensive definition (and I have not quoted it all) is a background for the really vital subdivisions, which exempt from recognition for tax purposes the profit or loss on specified exchanges — exchanges most of which would result in tax consequences under the Supreme Court decisions referred to. Thus no gain or loss for tax purposes is recognized if securities in one corporate party to a reorganization, Corporation A, are exchanged for securities in another corporate party to the reorganization, Corporation B.[13] Nor is gain or loss recognized if one cor-

[9] In 1934, the reorganization definition was sharply modified; and the provision of prior laws permitting a shareholder in one corporate party to a reorganization to receive additional shares in another corporate party, without recognition of gain or loss, was eliminated.

[10] Supplement R, Rev. Act of 1938.

[11] See, e. g., Miller, Hendricks and Everett, *Reorganizations and Other Exchanges in Income Taxation* (1931). See also Milton Sandberg, "The Income Tax Subsidy to Reorganizations", (1938) 28 *Columbia Law Rev.* 98.

[12] Sec. 112 (g), Rev. Act of 1938.

[13] Sec 112(b)(3), Rev. Act of 1938.

porate party to the reorganization exchanges its property for securities in another corporate party.[14]

On their face, these provisions permit a wide range of readjustments in the corporate structure, without tax consequences. On closer analysis, it is evident that the building-up of corporate structures into larger units is primarily contemplated. Several corporations can be merged or consolidated without the recognition of gain or loss to the stockholders or the corporations themselves, so long as no "boot" passes.[15] Combinations effected by means of the acquisition by one corporation either of 80 per cent of the stock of another, or of substantially all the properties of another, can likewise be accomplished free from income tax. Under another paragraph,[16] a business enterprise can be transferred from individual ownership into corporate ownership without the recognition of gain or loss. A business originally started with a small capital by an individual owner can grow into a corporation, and then can become either one subsidiary of a chain owned by a holding company, or one of the components of a large merging or consolidated corporation; the original investment of $100,000 in an individual enterprise may have been transmuted into a minority interest, worth many times $100,000, in the stock of the merging corporation. During all these years of corporate history, federal income taxes will have been payable on current income; but if the reorganization provisions have been complied with, the successive and far-reaching changes in the business structure will not have been made the occasion of an income tax, notwithstanding increases in value in the corporate assets, or in the securities issued against them.

In summary, the present revenue laws view with indifference the growth of corporate structures in the specified forms—they are not directly encouraged with a lower tax, nor discouraged with a higher tax, except in one major particular to be noted. Moreover, it should be emphasized that the potential gain or loss which is not presently recognized is not completely ex-

14 Sec. 112(b)(4), Rev. Act of 1938.

15 If "boot" passes, in general any gain is recognized to the extent of the boot. Sec. 112(c), Rev. Act of 1938.

16 Sec. 112(b)(5), Rev. Act of 1938.

empted; the recognition is in reality postponed until the stockholder terminates by sale or the like his investment in the enterprise.[17] On the other hand, the legislative policy over the last twenty years has not really been a passive one, for without the present tax provisions, undoubtedly many or most of the mergers, consolidations and other corporate reorganizations would have given rise to immediate tax liabilities under the prior Supreme Court decisions, and therefore would probably not have been consummated at all.

2. *Public Utility Reorganizations.* The Revenue Act of 1938 properly expanded the reorganization provisions to include various exchanges of properties and securities made pursuant to orders of the Securities and Exchange Commission, under the authority of the Public Utility Holding Company Act of 1935. For example,[18] Holding Company A comprises an integrated utility system in region X, but also owns the voting stock of Company B with transmission lines in region Y. Holding Company M comprises an integrated system in region Y, but also owns the voting stock of Company N with a generating plant and transmission lines in region X. In obedience to appropriate orders of the Securities and Exchange Commission, Company B transfers its transmission lines in region Y to Company N in exchange for the generating plant and lines of that company in region X. No gain or loss is recognized to either company.[19] The philosophy is that, since the federal government through its legislation and its administrative agency has compelled the exchanges to be made, it ought not also to collect tolls upon them. As in the case of normal voluntary reorganizations, the statute postpones the recognition of gain or loss until the property is disposed of by sale or the like, but does not eliminate all taxation of accumulated appreciation for all time to come. The noteworthy feature of these new sections for our purposes is that

17 This is accomplished by the "basis" section which provides for a carry-over to the securities or property received in exchange, with appropriate adjustments, of the cost or other tax basis of the property originally held. Sec. 113(a)(6) to (8), Rev. Act of 1938.

18 This example is substantially that given on page 29 in the Report of the Senate Finance Committee on H. R. 9682 (75th Cong., 3d Sess., Rep. 1567), which became the Revenue Act of 1938.

19 Sec. 371(b), Rev. Act of 1938.

the tax law has been so drafted as to interpose no obstacles in the way of carrying out the general legislative policy with respect to public utility holding companies.

3. *Holding Companies.* Although mergers and consolidations have received a form of indirect sanction from the tax laws, holding companies, whether designed for general commercial purposes or to hold personal investments, have been steadily discouraged. So far as business corporations are concerned, the most important of these adverse enactments go back to 1934 and 1936 respectively. Unquestionably they have had profound effects, though largely incapable of exact measurement, upon corporate policies. Some provisions designed to discourage personal holding companies were included in the first income tax law in 1913;[20] they were expanded in scope and in effectiveness in later years, notably in 1934[21] and 1937.[22] In combination with other sections designed to facilitate the liquidation of personal holding companies,[23] these provisions have undoubtedly brought about the wholesale elimination of such organizations.

From 1918 through 1935, dividends received by one domestic corporation from another were not subject to the corporate normal tax to the recipient corporation. The theory no doubt was that since the earnings distributed as dividends had been taxed to the paying company, they should not be taxed again to the receiving company. To this argument of equity, there may have been added arguments of policy; namely, that holding companies were frequently necessary or at any rate desirable, and that the revenue laws should not dictate their abolition by imposing upon a business organization in the form of holding company and subsidiaries a tax twice as great as that payable by a business organization of the same size, but conducted by means of a single corporation.

In the 1935 law, this situation was changed, so that, beginning in 1936, not 100 per cent but only 90 per cent of the

[20] Sec. II, A, Subd. 2, Rev. Act of 1913.

[21] By the addition of Sec. 351, defining certain companies to be subjected to an additional tax.

[22] The Rev. Act of 1937 was in large measure aimed at tax avoidance through the use of personal holding companies.

[23] See Sec. 112(b)(7), Rev. Act of 1938.

dividends received by one domestic corporation from another were to be deductible from its gross income in arriving at its taxable net income.[24] In 1936, a technical change was made, converting the deduction into a credit; and the taxable portion of dividends received was raised from 10 per cent to 15 per cent.[25] The provision was retained (with one change) in the 1938 law.[26] The effect is, then, to impose on earnings of subsidiaries distributed in dividends to a parent corporation a tax of approximately two and one-half per cent, a tax which would not be payable at all if the two corporations were merged into one. Hence in considering the form of corporate organization from the tax point of view, it is well to bear in mind that each holding company intervening between the ultimate individual recipient and the corporation whose assets are producing the income must bear this two and one-half per cent additional charge on any dividends received. The effect of this additional tax must have been to reduce materially the number of holding companies and also to reduce the number of subsidiaries set up to operate particular branches of the business.

The same result has been assisted in another way, by the elimination of consolidated returns. From 1918 through 1933, affiliated corporations[27] were permitted and at times were required to file a single income tax return, in which all the respective corporate incomes and all the deductions were consolidated, eliminating, however, intercompany transactions. Thus the losses of one subsidiary could be offset against the income of another subsidiary, or of the parent. Irrespective of tax considerations, consolidated income statements and balance sheets are commonly prepared for a parent and its subsidiaries, in order to reflect the actual net income and net worth of the enterprise as a whole. These statements are a

[24] Sec. 23(p), Rev. Act of 1934 as amended by Sec. 102(h), Rev. Act of 1935. The provision never in fact became effective, being superseded by the subsection next cited.

[25] Sec. 26(b), Rev. Act of 1936.

[26] Sec. 26(b) of the Rev. Act of 1938 limits the credit to 85 per cent of the adjusted net income of the recipient.

[27] This term was defined variously in the different laws. See Sec. 240, Rev. Acts of 1918, 1921, 1924, 1926; Sec. 141-42, Rev. Act of 1928; Sec. 141, Rev. Act of 1932.

tangible recognition of the business fact that, however important it may be to retain the separate legal identities of each of the various subsidiaries, they constitute in reality branches or departments of a single enterprise. In determining the net income of the enterprise, the incomes and deductions of all of its component parts should be thrown into hotchpot.

The 1934 law, however, eliminated the provision for consolidated returns, except in the cases of railroad corporations,[28] notwithstanding Treasury advocacy of its general retention.[29] The reasons were probably those stated in a subcommittee report:[30] (1) the provisions were particularly beneficial to large corporations; (2) the losses of one corporation could be offset against the gains of another, with a consequent reduction in tax revenue; and (3) intercompany transactions were freed from tax. None of these arguments is convincing as a matter of tax equity. The consolidated return was essentially a recognition for tax purposes of an existing fact: that affiliated corporations are a business unit, and should report as such. The denial of the privilege of filing such a return must be justified, if at all, on the ground that it is socially desirable to discourage business structures consisting of a parent and subsidiary corporations. The tax law does not attack bigness as such, for if the parent and subsidiaries can be and are merged, there need be no tax on the merger, and the merging corporation will enjoy substantially the same tax rates as all other corporations, large and small. It is the holding company relationship which is subjected to added tolls.

There has been a good deal of recent comment upon the unwillingness of capital to seek investment in new and risky enterprises. In so far as the two tax provisions just noted have had any economic effect, they have accentuated the trend. For it is common practice to segregate new enterprises and inventions into separate corporations, in order that the owner's entire capital shall not be staked on the venture. If this segregation is effected by means of a subsidiary company, the new enterprise incurs an additional tax load, and there is no provision for the deduction of the subsidiary's losses against the incomes of other subsidiaries or of the parent. Indeed, there is no adequate provision for carrying forward and offsetting the subsidiary's losses in one year against its profits in a future year. Finally, the increasing mass of tax-exempt bonds provides strong competition for new commercial investment of any sort. If it be true that there is nothing so timid as a million dollars, how can we expect that large amounts of capital will choose the uncertain return, the added tax burden, and the inadequate arrangements for the deduction of losses attendant upon a new and untried commercial investment, in preference to the Elysian Fields of a steady, though low, return, and partial or complete freedom from any sort of income taxation, offered by governmental securities?

[28] Sec. 141, Rev. Act of 1934.

[29] Statement of the Acting Secretary of the Treasury (1933), p. 12.

[30] Prevention of Tax Avoidance (Preliminary Report of a sub-committee of the Committee on Ways and Means, 1934), p. 10.

The operation of the tax laws in discouraging personal holding companies is so well known in general outline that I shall not dwell upon it at length. With personal income tax rates ranging up to 79 per cent, and corporate rates stopping at 19 per cent, the strong incentive for the retention of income by corporations owned by wealthy stockholders is apparent. Moreover, the ability to pay which is so often used as a yardstick of a good tax system is personal ability to pay—not the ability of the artificial corporate entities which legal ingenuity sets up between the living individuals who own them and the rest of the world. Hence steps need to be taken to insure that the income tax paid by or on behalf of an individual is measured, not alone by the income which he has pocketed directly, but by the income from capital or business which he has pigeonholed in one or more personal holding companies. The means now employed to accomplish this general result are twofold. First, the law[31] defines domestic personal holding companies explicitly as corporations meeting two tests; (1) 80 per cent of their income must arise from specified investment sources (dividends, interest, royalties, etc.); and (2) more than 50 per cent of their stock must be owned by or for not over five individuals and their families. Any income of such companies which is not distributed to shareholders is taxed at rates of 65 and 75 per cent in addition to the normal corporation taxes. These rates are, of course, prohibitive. The effect, therefore, is to force either the dissolution of such companies, or the

[31] Sec. 402, Rev. Act of 1938.

complete distribution of all their earnings each year. There can be little doubt that the personal holding company as defined in the revenue law is a vanishing organization. Some are still left, but their heyday is over for the present.

Foreign personal holding companies are somewhat similarly defined,[32] but here the undistributed corporate income is to be included, pro rata, in the tax returns of the individual American stockholders. Thus, the foreign personal holding company no longer serves to reduce its stockholders' taxes; and it, too, may be regarded as a rapidly waning device.

In the second place, surtaxes of 25 per cent and 35 per cent are imposed upon the undistributed income of any corporation, other than the two forms of personal holding companies, if its earnings or profits are permitted to accumulate beyond the reasonable needs of the business.[33] This latter provision has a long history, but not very much to show for it. Ordinary business corporations have little to fear, unless their stock is closely held by wealthy persons, and unless it is pretty clear that the accumulation of earnings by the corporation had little conceivable motivation save tax-dodging.

Corporations can be built out of individual enterprises or partnerships without tax on the accumulated increase in value of the investment. Corporations can be merged or consolidated, with very little additional income tax attributable to increased size.[34] The revenue law sanctions the large unified enterprise with a lower rate of tax and fairer deduction provisions than are accorded to the enterprise broken up into holding company and subsidiaries. Personal holding companies are severely penalized, with a view to driving them out of business. All these provisions are directed primarily to the form of the business unit. How does the revenue law affect problems of capitalization and fiscal policy?

II. Capitalization and Fiscal Policy

The pertinent sections are not very extensive, and not very intelligently devised. In the first place, we have the capital

[32] See Sec. 331, Rev. Act of 1938.

[33] Sec. 102, Rev. Act of 1938.

[34] The corporation normal tax is, in general, 16½ per cent. For corporations with net incomes under $25,000, the rates are 12½ per cent to 16 per cent.

stock and excess profits taxes upon corporations, Siamese twins intended to secure for the government an excise of $1 per $1000 of the declared value of corporate stock.[35] If the value of the stock as declared were its actual book value, or its market value, the amount of the outstanding corporate bonds, notes or other obligations ranking ahead of the stock would have been subtracted, in one form or another. As the tax works out, the declared value approximates ten times the annual corporate earnings. Net earnings are arrived at after a deduction for interest paid. Hence there is here a mild, but double-barreled encouragement to the use of bonds, notes or debentures in the corporate capitalization, rather than stock. The value of the bonds, notes or debentures will not be taxed to the corporation; the value of the stock will be.

A similar sanction of the issuance of bonds rather than stock appears in the two income tax sections, whereby the interest on indebtedness is deductible in arriving at taxable net income;[36] dividends on stock are not; and yet interest and dividends are now taxed exactly alike to the individual recipient. Thus, if the corporation and its owners are viewed together as a taxpaying group, they will pay less income taxes, as well as less capital stock taxes, if they utilize bonds or debentures rather than stock as evidence of the investment of the enterprise.

This result seems odd and unintelligent. Until 1936, individual stockholders were not subjected to the normal tax on account of dividends received, but only to the surtaxes. The theory was that since the corporation had already paid a normal tax on its net earnings, a second normal tax should not be imposed on the same earnings when distributed as dividends. The corporation was thus regarded as a conduit for transmitting earnings from the business to its owners, not as a taxpaying unit entirely apart from its owners. The 1936 change greatly increased the revenue from the individual income tax; how much it has actually affected corporate capitalization is not determinable. Notwithstanding its results in revenue, the change seems undesirable. The corporation normal tax rates are much higher than the normal rate applicable to income

[35] Sec. 601 and 602, Rev. Act of 1938.

[36] Sec. 23(b), Rev. Act of 1938.

from individual or partnership enterprises.[37] That dividend payments have borne and been reduced by income taxes on the corporation is a generally accepted fact. To restore the credit against the individual normal tax on account of dividends, or indeed a somewhat larger credit, is justifiable on grounds of tax equity. It is further justified by the undesirability of encouraging increases in corporate indebtedness by a tax sanction.

The fragment of undistributed profits tax[38] remaining in the law—a 2½ per cent tax upon undistributed corporate earnings—will hardly have any really material effect upon corporate practices. If a business corporation has need for its earnings, or if its principal stockholders do not desire to pay surtaxes upon distributions, the 2½ per cent tax will scarcely be an effective deterrent to income retention. The tax is adequate neither to force distribution, nor to make up for lost surtaxes on undistributed income. It is simply an additional excise tax upon the doing of business in corporate form, having no apparent justification from the points of view either of increased equity in taxation or of improved corporate practices. Whatever may have been the merits and the demerits of its predecessor, and they were many, the present undistributed profits tax is an extremely cumbersome method of raising a very small amount of money.

III. Conclusion

Even this brief survey has indicated the outstanding characteristic of the present federal taxes on corporations—they are needlessly complex. Actually there are six different taxes imposed on domestic corporations, and they seem to be levied upon three different theories, two to a theory.[39] There is no apparent reason why the three major taxes to which every business corporation is subject should not be telescoped into one. If this were done, the cost of computing and paying

[37] Individual *surtax* rates, as heretofore stated, rise to levels much above the corporation normal tax rate.

[38] See Sec. 13, 26, 27, 28, Rev. Act of 1938.

[39] The capital stock and excess profits taxes are evidently levied for the privilege of doing business in the corporate form. The corporate normal tax and undistributed profits tax are usually justified as parts of the personal income tax system. The taxes imposed by Sec. 102 and by Sec. 401 are designed to prevent avoidance of individual surtaxes.

taxes, now a serious item, would be reduced. Moreover, the appraisal of the economic effects of taxes would be much easier to make. We might reasonably expect that this fine-edged tool of taxation would be used more skilfully, if its results were more fully understood.

Since the great growth of the federal tax system has occurred in less than a quarter-century, there has hardly been time for comprehensive studies of its far-reaching effects. Attention has normally been directed to immediate questions of tax equity, not to long-range consequences. Merely to devise a tax system which operates fairly within itself is a major problem in social engineering. The best informed and most judicious mind is convinced of its own inadequacy to determine just tax treatment for all sorts and conditions of men, for diverse businesses and forms of organization, large and small, rich and poor.

Since so many complexities are inherent in the tax system itself, extreme prudence would counsel that the tax system should never be used as a vehicle of social or economic reform; the risk of complete failure, due to inability to forecast and evaluate all consequences, is too great. I would not go quite so far. In my judgment, the recent amendments to the revenue act to ease the tax burden upon utilities compelled to reorganize were fully justified. The amendments will not increase the revenues, and were not proposed for that purpose. Their sole function was openly avowed and well understood: to remove the tax obstacle from the path of an economic policy fully debated and finally agreed upon. By the same token, if recommendations for amendments to the revenue laws are proposed by the National Economic Committee, their significance in forcing the adoption of desired economic policies should be fully discussed and their merits weighed quite apart from their revenue effects. The principal danger in proposals of this sort is that their hybrid character will not be understood; or that their probable consequences, quite apart from the revenues involved, will be obscured or inadequately appraised. Such discussions as the Academy has arranged this year are notably valuable in fostering a broader appreciation of the numerous complexities of one of our major public problems—an appreciation which is the first essential to an intelligent solution.

Remarks by the Chairman

Chairman Burgess: I am not sure whether we should be dominated by regret that Professor Magill is no longer Under-secretary, or with rejoicing that he is now free to speak his mind. In any event we are grateful to him.

In the course of his remarks Mr. Arnold referred very briefly to the Sherman Anti-Trust Act and, obviously, any program such as this would be incomplete without a somewhat fuller discussion of that act, so the next topic is " The Sherman Anti-Trust Act and the Newer Problems of Trade Restraint and Competition ", and the speaker will be William L. Ransom, trustee of the Academy of Political Science, attorney-at-law, and former president of the American Bar Association.

THE SHERMAN ANTI-TRUST ACT AND THE NEWER PROBLEMS OF TRADE RESTRAINT AND COMPETITION

WILLIAM L. RANSOM
Trustee of the Academy of Political Science
Former President of the American Bar Association

As we come near the close of this open forum as to monopoly, restraint of trade, free markets, the Anti-Trust Act, and the hoped-for restoration to some extent of free and independent enterprise, many of us may share the point of view of a lady who bought several of Professor Einstein's books. A friend asked her if she had read and enjoyed them, and she said that she had. Then her friend asked if she understood them; her reply was, " I understood the *words,* but I couldn't understand the *sentences.*" Some of us may have like difficulty in understanding recent discussion of some of the newer phases of the laws against monopolies and restraint of trade.

I am sure that no one would wish to leave an impression in the mind of anyone that we are dealing here with standards which are as exact as natural science and as specific as the multiplication table. Mr. Arnold, of course, would not suggest here that the problems can be solved—among self-respecting business men or otherwise—merely by exhibiting or giving to them a copy of the statute, so that he who runs may read and he who reads may run. Nor can everything be solved by simple processes of injunction, dissolution, indictment, consent, decree or conviction. Nothing in this field can be made as simple and specific as all that, no matter how sincere and enlightened are the good faith of the business men and their willingness to seek fair solutions according to the law. If, as has been suggested here, violations of the Sherman Act are " more like traffic violations " than like violations of the statutes defining crimes, it remains true that no speedometer has yet been devised, for either the driver or the policeman, to measure or check transgressions of the speed limit. The man who wants to go ahead no faster than he should go has still a hard time in finding out from the sign-boards along the way just how far and how fast he may go without risk of being indicted or sued for doing things, which no plain wording of the law can be read to forbid. I am sure that my friend Arnold would wish me to emphasize this phase of the matter, because it points and high-lights the difficulties with which he, no less than American business men, are having currently to deal.

A Reëxamination of Fundamentals Is at Hand

Beyond a doubt recent events (and I am not referring today to anything too recent) have assured us that reëxamination of the structure of industrial organization in America is at hand. An important part of that process may be the fostering of a reasoned public opinion, in aid of the constructive studies which have been projected by those in charge of the matter in the Congress, the Department of Justice, the Securities and Exchange Commission, and other federal agencies represented in the Temporary National Economic Committee. As always, the Academy of Political Science is glad to make whatever contribution it can, toward the informed discussion of the subject in an " open forum " in which the Academy sponsors no particular views but only the qualifications of its speakers to present reasoned opinions or significant information.

American Ideals of Life Are Deeply Involved

The Supreme Court has admonished us all that in construing and applying the Sherman Anti-Trust Act, " Realities must dominate the judgment ".[1] In such a spirit the Academy would wish to make its traditional contribution.

When we talk—perhaps too glibly—of market controls, consent decrees, integrated combinations, common-law principles against restraints of trade, techniques of enforcement, and the rest of the formidable vocabulary of this subject—as though these matters were wholly impersonal and mechanistic—we should never forget that in reality we are dealing with the things by which men and women live, maintain standards of comfort, rear and educate children, achieve a sense of independence and opportunity, and provide somewhat for their own security in old age. If there are ways of life and ideals of living that are characteristically American, they are rooted deep in this field of law and will be profoundly affected—either helped forward or weakened—by whatever is now done by government. Industry is the means through which communities and individuals lead their lives and work out their destiny; we have learned that concentrations of economic power may attain great efficiency and economy in the production of goods, may accomplish wide and popularized dispersion of goods, but may fall short of fairness in distribution and may inflict incidental social damage in so doing. We are concerned here with the impact of modern industrialism and the eagerness for size for its own sake, upon the small town, the small factory, the individually-owned store, the hope for serene and leisurely and contemplative ways of independent living. We may be confronted with an old issue between reality and hope, reality and theory—who would turn back the clock?

[1] *Appalachian Coals, Inc. v. United States*, 288 U. S. 344, 360.

The Sherman Act Has Withstood Passion for Novelty

A significant fact, at the threshold of our inquiry into the newer aspects of this old subject, is that during the nearly fifty years which have followed its enactment, the substantive provisions of the Sherman Anti-Trust Act stand virtually in the form in which they first became law.[2] The years since 1890 have witnessed vast changes, in the United States and the world. The economic, industrial and political structures of society have been profoundly changed. Industrial organization, methods, and even objectives, have been largely reformed. Legislation has invaded almost every field of business and life; an incessant change in laws has been the vogue, during a great deal of the fifty years. Yet the basic statute for preventing monopoly and preserving what may be preserved of free competition and independent enterprise remains essentially unchanged.

It is significant also that in practically every other field, the activities of government in relation to industry and business

[2] July 2, 1890, c. 647, § 1, 26 Stat. 209. This statement is subject to exception for the "Tydings Amendment", approved August 17, 1937, which introduced into Section 1 of the Act the "provided" clauses contained in the text as later quoted.

have in recent years been entrusted primarily to administrative discretion exercised through boards and commissions. The inclusive phrases of the Sherman Act have remained as sacrosanct as though they were embodied in the Constitution itself, and have been said by the Supreme Court to have " a generality and adaptability comparable to that found to be desirable in constitutional provisions ".[3] The interpretation and enforcement of its " general phrases " have wisely been left to the courts, in suits brought by government.

So far as my judgment goes, this long adherence to the judicial process in this field has been both fortunate and sound; and the traditional preference of the Department of Justice for orderly adjudication by impartial and law-governed courts should not for any light reasons be abandoned in favor of newer fashions and more showy vogues. The meaning and application of the statute may best be arrived at by that moderate and remedial course which the Supreme Court has called "the gradual process of judicial inclusion and exclusion."

The Sherman Act Was Long Believed to Have Worked Fairly Well

There was a time when it was rather generally believed, by competent observers at first hand, that the Sherman Act had fulfilled its purposes fairly well and had played its part in helping to preserve essential characteristics of American industry and life. It was even supposed by many persons that the meaning and application of the Act had been determined with reasonable clarity and certainty, through the adjudications obtained in many enforcement proceedings.

When that distinguished friend of this Academy, Mr. James Bryce, later Viscount Bryce, came back to America in 1914, he wrote for his *The American Commonwealth* such footnotes as he found were necessary to reflect the changes which had taken place in the phenomena of life and government, from those which prevailed when he wrote in 1894. He undoubtedly had the Sherman Act in mind when he wrote, in one of these footnotes added in 1914:[4] " The power of wealth, and especially the power of great corporations, has begun to decline. It

[3] *Appalachian Coals, Inc. v. United States*, 288 U. S. 344, 359.

[4] *The American Commonwealth* (edition of 1914), vol. II, p. 654.

had gone so far as in 1900 to arouse fear and resentment and since has been curbed."

Renewal of Assertion That Meaning of the Law Is Undetermined

It may be anomalous, if not surprising, that, after nearly fifty years, the meaning and application of this venerable statute are now said to be still largely undetermined. Lately we have beheld a profusion of law suits started for the avowed purpose, among other things, of obtaining judicial rulings and declarations as to what the language of the Sherman Anti-Trust Act means or can now be construed to mean. Such judicial interpretations and clarifications of the statute are sought, it is said, after nearly fifty years of its active operation, to the end that the Congress may be aided in determining what further legislation, if any, should now be considered and enacted, to further and fortify the purposes of the Sherman Act. In the United States District Court for the Southern District of New York, the government of the United States has recently thought it necesary or wise to file a brief devoted to a broad and comprehensive discussion of " The Meaning of the Sherman Act ". The Act itself comprises a few lines, on less than a printed page; the brief devotes 74 pages to presenting the government's theory of what the Act says and means.

The Pressure for New and Added Meanings

With full recognition that clarification by adjudication is the orderly and constructive course, we may note, and perhaps reserve judgment upon, an inquiry as to whether the need and objective of present efforts are decisions by the courts as to what the Sherman Act means and requires, rather than new decisions by the courts to effectuate what the government believes that the Sherman Act may and should be construed now to mean, in the light of the greatly changed conditions of today and tomorrow. That is just what the provisions of the Act permit and contemplate (if we leave out of present consideration the dubious provisions added by the Tydings Amendment of 1937). Just as has taken place with the commerce clause and the due process clause of the Constitution, the " general phrases " of the Act may be " interpreted to attain its fundamental objects" in the light of present-day conditions and needs.

It is interesting to note what the government of the United States, in its recent brief to which I have referred, says about the Act now nearly a half-century old:

> In view of the generality of the Act's prohibitions, its lack of detailed specification of proscribed conduct, and the variety of situations to which its provisions are applicable—since the Act embraces the entire field of interstate and foreign commerce—there is no single case or even group of cases which sets forth a complete and definitive exposition of the meaning of the Act. Different situations have called for different tests or standards of legality or at least have led to varying emphasis upon particular factors and considerations. . . .
>
> . . . the crucial words of the statute are, as previously stated, not words of exact meaning, and their force and application are therefore largely based upon and dictated by the Courts' conception of the purposes and objectives of the statute.

The Text and Scope of the Sherman Act

We may advance here our understanding of the subject by referring to the text of the statute, in the form in which its substantive provisions have stood during nearly fifty years. There have been two sections; both the titles and the text are worthy of present note:

> *Section 1. Trusts, etc., in restraint of trade illegal; penalty.* Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal.[5] Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding $5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the Court.

[5] The Tydings Amendment of 1937 inserted at this point the following: "*Provided,* That nothing herein contained shall render illegal, contracts or agreements prescribing minimum prices for the resale of a commodity which bears, or the label or container of which bears, the trade mark, brand, or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made, or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition under Section 5, as amended and supplemented, of the Act entitled 'An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes', approved September 26, 1914: *Provided further,* That the preceding proviso shall not make lawful any contract or agreement, providing for the establishment or maintenance of minimum resale prices on any commodity herein involved, between manufacturers, or between producers, or between wholesalers, or between brokers, or between factors, or between retailers, or between persons, firms, or corporations in competition with each other."

> *Section 2. Monopolizing trade a misdemeanor; penalty.* Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding $5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the Court.

Affirmative Acts of Unfairness Are Interdicted

The prohibitions declared by Section 2 are inherently embraced within those of Section 1. To "monopolize" trade or commerce is to impose an undue restraint upon trade or commerce. It should be significant that the word "monopoly" was not written into either section. The use of the verb "monopolize" has seemed to me to reflect an intent to interdict *affirmative acts.* To "monopolize" seems to me to connote overt and affirmative acts to take away or lessen, in some manner contrary to "the fitness of things" and "the rudiments of fair play", existent competition or the opportunity to enter upon competition or to continue in competition. *Size* is not condemned because of size; efficiency, skill, inventive genius, and ability in management are not interdicted, although their existence and operation may lessen or make less attractive the opportunity to compete with existing enterprises.

To "monopolize" implies curtailment, by overt and colorable acts, of existent competition or of the opportunity for new and independent enterprises to enter upon competition on fair (although not necessarily equal) terms.

"Integrated Combinations" vs. "Loose Combinations"

Monopolization or restraint of trade may arise

(1) from owning or acquiring properties or property rights and then using them in some manner contravening fair

play, in impairment of free markets, natural prices and open competition, in which event the resultant restraint is called an "integrated combination", for which the remedy is by decree for dissolution; or

(2) from contracts or arrangements or concerted action, by persons or corporations otherwise independent and competing, whereby their own competition between themselves or the potential competition between themselves and others is in some essentially unfair manner lessened or destroyed—this type of "combination" or restraint being known as a "loose combination", for which the remedy is appropriately by injunction against the agreements or consensual arrangements which impair the free play of the market.

Judicial Interpretations and Applications of the Law

The Supreme Court has made many authoritative statements of the purposes and application of the statute. The Court has said:

> The Sherman Act was intended to secure equality of opportunity and to protect the public against evils commonly incident to monopolies and those abnormal contracts and combinations which tend directly to suppress the conflict for advantage called competition—the play of the contending forces ordinarily engendered by an honest desire for gain.[6]

The great Court has declined to interfere with a conviction voted by a trial jury where the district court charged the jury that it might find the defendants guilty of unlawful price-fixing, without regard to the reasonableness of the prices fixed (by a "loose combination"), or the good intentions of the parties to the combination or whether prices were actually lowered or raised.[7] Potential power to accomplish a prohibited purpose was deemed to outlaw the arrangement between the accused producers. The Court said:

> Our view of what is a reasonable restraint of commerce is controlled by the recognized purpose of the Sherman Law itself . . . it cannot be doubted that the Sherman Law and the judicial decisions interpreting it are based upon the assumption that the public interest is best protected from the evils of monopoly and price control by the maintenance of competition. [Citing cases.]

[6] *United States v. American Linseed Oil Company*, 262 U. S. 371, 388.

[7] *United States v. Trenton Potteries Company*, 273 U. S. 392, 397-398.

> The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. . . . Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints. . . . Thus viewed, the Sherman Law is not only a prohibition against the infliction of a particular type of public injury. It "is a limitation of rights, . . . which may be pushed to evil consequences and therefore restrained."

On the other hand, in declaring that "the Anti-Trust Act aims at substance" and that "the question under the Act is not simply whether the parties have restrained competition between themselves but as to the nature and effect of that restraint", the Court ruled that

> A cooperative enterprise, otherwise free from objection, which carries with it no monopolistic menace, is not to be condemned as an undue restraint merely because it may effect a change in market conditions, when the change would be in mitigation of recognized evils and would not impair, but rather foster, fair competitive opportunities.[8]

Can Statutes and Judicial Process Protect Individual Opportunity?

Time does not permit me to go further into analysis of decisions under the Act—after all, we are here concerned more with the policy, the constructions and applications to be sought in future adjudications, and the significance of the present renewal of the mooted issues. Before we note and comment upon some of the new frontiers and new problems of application of the Act, it seems appropriate to say that during nearly fifty years the Sherman Anti-Trust Act has signified and symbolized to the American people the idea that in some way the statute law and the judicial process can defend and protect individual opportunity and independent enterprise[9] and make human values more secure in fields where large concentrations

[8] *Appalachian Coals, Inc. v. United States*, 288 U. S. 344, 373-374.

[9] *Cf. Sweden: The Middle Way*, by Marquis W. Childs. "In Sweden those who have been most active in the warfare against monopoly control of wealth and industry have never at any time relied upon the law; legal barriers against monopoly are entirely futile, in the opinion of these practical leaders" (p. 5). Nothing resembling the Sherman Anti-Trust Act has been on the statute books in Sweden (p. 162).

of capital, inventive genius and aggressive management have been or are tending to dominate the scene. In the face of abundant demonstrations that earnest efforts to regiment and readjust industry by law and decree often blow up and recoil violently in the faces of their sponsors, the hope or aspiration innate in the Sherman Act persists.

The particular types of trusts, contracts, combinations and monopolistic acts, which were in the minds of the eminent authors of the Sherman Act, have long ago disappeared from American industry.[10] The broad phrases of the Act no longer have their original connotations and negations, but it is still hoped that somehow they may be construed reasonably and remedially as embodying popular hopes and aspirations which do not die out or disappear.

Fidelity to the Sherman Act Is Characteristically American

The statute remains as a prohibition against affirmative acts by existing enterprises, designed to narrow and lessen the opportunity for others to enter the field, or to make it difficult for smaller, independent enterprises to remain in the field. It in a sense incarnates the point of view of those who have not fully accepted and surrendered to the impact of industrial and mass organization, of capital and of labor, upon the small city and the village, and upon the small business, and upon the ceaseless ambition of the wage-worker to become proprietor.

Fidelity to the Sherman Act has traditionally been almost as characteristic of American life as our belief that a middle class can be preserved and that all efforts to substitute the Marxian philosophy of class-conscious conflict between bourgeois and proletariat can be resisted. It would be difficult to overemphasize here the significance of this traditional and persistent faith that in America the doors of hope and opportunity can in some way and to some extent still be kept fairly open to individuals and small enterprises on their merits.

[10] E. g., the "trusteeing" of the stock of several corporations, to ensure a common control and concerted action. *Cf. Standard Oil Company v. United States*, 221 U. S. 1. The "trust" and related forms of early "combinations" were due largely to the existence of state laws which then in effect prohibited or limited mergers, consolidations, ownership of the stock of one business corporation by another, etc.

Are Contrary and Inconsistent Forces at Work?

If we accept the persistence of the Sherman Act, in its original form, as typifying in law and governmental policy the desire and determination of the American people that the chance for the small business, the individual enterprise, the new competitor, shall be saved at almost any hazard, then we shall have to inquire sharply whether or not it is true that there are many conditions, laws and policies which are operating sharply and definitely in the opposite direction—away from opportunity for the small business and the new, independent enterprise. Some of these trends have the force and the aid of law and governmental boards; others have deep roots in popular habits and thinking. Are we prepared to give up the stability which goes with size in financial institutions, the efficiency and quality and cheapness which go with size in the manufacturing industries, the security which comes from assured employment and modern provisions by private industry for the welfare of workers in old age or disability? Our people may have to make up their minds whether they wish to give up their ideal of open, fair competition and opportunity to compete, or are willing to revise and discard some other concepts which are directly hostile. I shall not be able to discuss here the merits of any of these, apart from our present subject; I may be able to pose a few of them for your consideration.

"Advertising" and "Consent Decrees"

In the first place, we may note what has been said as to the popular preference for nationally known, nationally advertised brands of goods? Does such a prevalent state of mind in itself operate to lessen the opportunity for small and independent enterprises to come in or to stay in? People have fallen into the habit of buying names, brands, slogans, wrappings, containers—made known by advertising campaigns not available to small concerns. These trends have made for quality, for cheapness, for convenience, for the growth of stable enterprises giving employment to vast numbers of people at good wages and upon modern bases of social security. Would we be willing and ready to try to turn back the clock, in order to give new meanings and applications to this venerable statute?

I am glad that our friend Arnold brought up this subject of advertising here today, in his comments on the Ford and Chrysler decrees submitted day before yesterday. He has revealed strikingly the new frontiers to which his quest for interpretation and enforcement of the Anti-Trust Act may carry us. Advertising " for consumption " may prove to be something like " production for use ". The theory of the proposed curtailment seems to be that advertising should promote an industry, not particular concerns in it, and should encourage use of the product rather than increase the sales of a particular producer.

Attempts to clarify the Act by " consent decrees " rather than by adjudication are bringing many challenging questions, whose implications we may not readily accept. Even if it be true that these " consent decrees " will mark and point the channels through which business may pass in safety, such a process of " clarification " by putative " consent " leaves much to be desired.[11] The ideology of these decrees seems vastly different from that of the Senate debates which led to the enactment of the Act in 1890.[12]

To illustrate: Day before yesterday (November 7), Mr. Arnold's release for the Department of Justice said, as to financial ability to advertise:

> By the provisions of these decrees, a step is also made toward *restricting advertising to its proper field—which is the promotion of sales—* and toward preventing its use for the fostering of monopoly and monopolistic practices. The decrees in the present cases may become most important precedence in preventing the mis-use of advertising power in other fields.
>
> Monopoly is fostered when advertising is used to put competitors at a disadvantage for the sole reason that they do not have resources sufficient to expend equally large sums in advertising particular products or the services of particular companies. . . .
>
> Like conditions obtain in the advertising of commodities,—vast sums being expended to advertise particular brands of such common products as gasoline and milk. In the oil industry, to take one example, refiners

[11] The consent decree has been said by the Department of Justice to be "a practical solution which is of major and immediate benefit to the industry, to competitors, and to the public, and *which goes beyond any results which can be expected from a criminal proceeding.*"

[12] 21 *Congressional Record*, Part 4, pp. 3151-3152, 3857, 4088-4090, 5950, 5981.

> are deprived of their market because of the belief induced by great expenditure that good gasoline is sold only under particular trade names. The use of trade names itself is old in our law and has a proper function in identifying to the public the goods of manufacturers known for their reliability and integrity. But with the advent of modern advertising the trade name has taken on a new use. By a variety of modern refinements upon the methods of the circus barker, advertising is used to build up public preference for the products of one producer or manufacturer solely because he has the most advertising money and can make the most noise. To meet the monopoly control which this advertising gives, the antitrust laws by themselves are inadequate. Such a method of advertising has never been held to be violative of the antitrust laws, and the legality of its use, in the absence of positive fraud, has not been questioned. Nevertheless, *the purpose of the antitrust laws will be furthered if advertising is limited to its proper function of building up consumption,* and if restrictions are placed against its use for the purpose of giving a monopoly advantage to the competitor with the largest pocketbook. *Where advertising stresses the peculiar qualities of common goods under a particular trade name, competitors must either go out of business or spend like large sums in building up their own trade names for the same common commodity.* The result is either a wasteful system of distribution on the one hand, or monopoly on the other. (Italics mine.)

Some of us may have felt at times that national advertising leads to a lot of healthy competition between products and between producers, but hardly to restraint of trade or to monopoly under the Sherman Act. The particular challenge to advertising may come close to invasion of the prerogatives of a free and independent press.

Overcompetition Is Major Present-day Offense

In fact, we are hearing nowadays that not monopoly or combination but overcompetition may offend most grievously against the Anti-Trust Act. I submit to you, illustratively and without comment, the following from the official " release " of the Department of Justice on October 15, 1938, as to its investigation of the milk industry in the Detroit area. After describing what had taken place, the " release " said:

> *Such conditions of over-competition inevitably lead to violation of the antitrust laws.* In many cases the cycle is as follows: Large distributors who dominate the distribution system have the farmers at their mercy because of the enormous supply of milk that is produced. In self defense farmers combine in order to keep up prices. Such combinations are ineffective unless they eliminate a portion of the supply. Groups of

farmers, therefore, out of the necessity of surviving under such difficult conditions, combine to keep other farmers out of the market who are threatening them with ruinous competion. This is to prevent the inevitable price cutting caused by the fact that there is no market for the total available supply at fluid milk prices. It results in the artificial restriction of milk sheds by various sub-rosa methods. Farmers who do not belong to some inside milk ring are thus excluded from the market. Combinations between farmers and distributors which go beyond the authority of the Capper-Volstead Act are frequent. The distributor, because of his dominating position, usually controls the price.

Where unrestrained price competition exists the farmers bear the brunt of the competition. This makes such a condition unstable. It is apt to last only so long as is required for the farmers to organize to raise prices so that they may obtain a living income.

Due to the competitive situation in Detroit, as already stated, it is almost inevitable that there will be pressures to raise the prices received by the farmers, and that these pressures will succeed to some extent. If and when they do, competition from interstate sources will immediately be felt. Then the interstate aspect of the problem will become acute. (Italics mine.)

Other Challenging Questions as to Possible Inconsistencies

I could cite to you many challenging instances of apparent inconsistencies between governmental policies and the supposed furtherance of small enterprise. What of the effects of governmental policies as to compelling collective bargaining with large vertical unions? Small enterprises in the smaller cities and towns got along and prospered, under collective bargaining with trades-unionism. Does enforced bargaining with industrial unionism leave the small enterpriser the same chance to survive?

What of the size and forms of organization and the price policies requisite for the race for place in foreign markets? What of the government's own mandates for curtailing production (of crops), artificial " rigging " of the price markets, and " two-price " subventing of free competition? What of the effects of governmental policies as to the issuance and sale of securities in a national market to finance enterprises old and new, the restrictions on equity financing, the burdens of taxation, the multitude of reports and regulations imposed—whatever may be the merits of these in any other respects, do they not tend inevitably to deter or drive out the small enterpriser?

Minute and drastic regulation by government has rarely aided small business.

Again: Has not vast development of the credit system tended to develop and foster large units and to close the doors of opportunity to the small business? [13] Pay-as-you-go is the traditional economy of small business; has not the credit system lent itself to interlockings of financial power and concentrations of economic power, hardly consistent with the avowed reasons for the intention and enforcement of the Sherman Law?

Fair Reëxamination of the Sherman Act Will Be Welcomed

American lawyers, American business men, all elements in American life, I feel sure, will welcome and aid a fair and constructive reëxamination of the fundamentals and objectives of the Sherman Act, to see if other governmental policies are in any vital respects inconsistent and in need of modification, to see if there is need for loosening or breaking now any of the interlockings which are popularly believed to confer improper powers and controls, and to see if this historic charter of free competition and of opportuuity for independent enterprise needs now to be amended, supplemented or strengthened. In a vital sense, the American ideals of life and opportunity are at stake, in all that pertains to this statute. Who is ready and willing to " sign off " and confess failure—that these objectives cannot be nurtured and advanced?

With whatever faults and ambiguities may be inherent in such a statute, I do not think it could truly be said that America has discarded, in favor of any totalitarian economy in the name or guise of planning, the characteristically American objectives of the Sherman Act.

[13] *Cf. Land of the Free*, by Herbert Agar: " For credit finance is the enemy of small property. It calls into being the giant combines which have dominated the modern world, overshadowing governments and obliterating the individual. . . . We must never lose sight of the fact that sound finance—paying your way as you go—is the friend of small property " (p. 265).

Remarks by the Chairman

CHAIRMAN BURGESS: That ought to make the record more attractive, Judge Ransom.

We come now to the period of discussion and that will be introduced by Mr. Thurlow M. Gordon, an attorney formerly connected with the Department of Justice and with the Federal Trade Commission. Mr. Gordon!

PUBLIC POLICY TOWARD CONCENTRATIONS OF ECONOMIC POWER: DISCUSSION

THURLOW M. GORDON

THE discussions here today have emphasized the great importance of the economic investigation which is shortly to be initiated by the Temporary National Economic Committee. Whatever our own views may be, it is quite clear that the existing economic order will be up for reëxamination and will be required to justify itself in the light of existing conditions. I am sure that industry will welcome a scientific and open-minded approach to this problem from an economic rather than a legalistic or political standpoint.

As I have listened to the very able speeches before this meeting, I have been impressed by the fact that we are more and more turning toward the definition of the issue—as some of the members of the T.N.E.C. have already defined it—as the problem of how to secure the maximum use of all our national resources.

By implication that involves, so far as may be, the continuous employment of labor, machinery and liquid capital—to secure the greatest production of goods and their distribution at the lowest cost. That is a program with which everyone can agree. Capital is as eager as labor to be kept continuously at work. The trouble is that it is one of those higher generalizations. The real difficulty is to work out the practical economic means by which that objective is to be attained.

Until we have worked out those economic means, it will be useless for us to apply to industry additional, severe, repressive sanctions—indictments, punitive taxes, the forfeiture of the right to engage in interstate commerce—or any other sanction which is not calculated to advance our thinking as to the ultimate objectives.

I have said that the real difficulty is to determine the economic means by which that ultimate objective is to be attained. I do not believe that anyone has as yet offered a satisfactory solution of that problem. I certainly have not heard one here today, and I do not believe there is any single, simple solution.

The number of factors involved is so great that they cannot be fitted into any simple little catchword formula such as

"bigness is badness",
"rigidity of prices",
"price uniformity against Oriental haggling",
monopoly, duopoly, or oligopoly.

I was particularly pleased to hear Thurman Arnold state today—what I knew he already felt—that the problem is not to be solved by atomizing industry. If the real objective is efficiency, then the form of our economic organization is only secondary. Efficiency may mean large-scale production—mass production and mass distribution—for the steel industry. It may mean littleness for pants pressers. In any event, the form of organization is secondary.

Neither do I believe that there is any way to determine the question of degree as to what is the optimum size of the efficient economic unit in any particular industry. The conditions vary so much in different industries, and under different conditions, that any policy which seeks to break up large-scale units by consent decrees—or by bleeding them to death by discriminatory taxes until they die of anemia—does not seem to me to be either practicable or fair.

Neither do I think that the objective—the maximum efficiency in the use of our national resources—can be attained, as some seem to believe, merely by compelling the maximum conceivable amount of competition that it is physically possible to create. The problem is not nearly so simple as that.

I was interested to hear Professor Mason say today that competition itself, when carried to extremes, is an evil. With that statement I heartily agree. Competition is not a panacea. It is not an end in itself. It is only a means to an end. It is something that we tolerate only because we do not yet know any better way to achieve certain results. And the amount of competition that is necessary to achieve the desirable results has, in my opinion, been grossly exaggerated.

Dr. Morgenstern has told us here today that the attempt to do away with competition altogether—and to substitute the systems of regulation employed in the totalitarian states—has produced exceedingly undesirable consequences. But, on the other hand, we in this country have seen the horrors of excessive competition, as evidenced by the complete breakdown of our own system in the panic following 1929—when everyone was competing desperately for volume—when prices sank so low that not only the marginal producers but the efficient producers, whose product is necessary to supply the normal needs of the country, were carried down into bankruptcy—and the savings of the people were destroyed.

We have seen the conditions existing in the chronically depressed industries—such as the coal industry and the textile industry—

where we have had decivilizing influences at work over a long period of time; and competition has not served to cure those conditions.

I feel certain that before we get through with the T.N.E.C. investigation, we shall find that we have too much, rather than too little, competition in many industries. You can not build a great industrial civilization upon a quicksand.

Thurman Arnold has already recognized this. In speeches before today, and in his remarks today, he has said repeatedly that competition should not be carried beyond the point where orderly markets are destroyed—that the public interest is not served by those extremes of competition which destroy the health and solvency of the competitors.

If the T.N.E.C. does reach that conclusion, and I believe it will, I think that most, if not all, of the stabilizing arrangements which may be necessary in the public interest can be accomplished without serious changes—fundamental changes—in the anti-trust laws. I have never been a believer in the theory that the Sherman Act must be interpreted by what Professor Gray used to call the Balaam's Ass theory of jurisprudence "in tones importing absolute verity, accompanied by no trace of conscious intelligence."

The Supreme Court has held repeatedly that industries may coöperate to a very high degree and yet retain all the competition that is socially desirable. Mr. Justice Brandeis so stated in the *Board of Trade Case*.[1] Mr. Justice Holmes so stated in the *Window Glass Case*.[2] So did Chief Justice Hughes, in the *Appalachian Coals Case*.[3]

After all, there is a rule of reason, and, as Mr. Justice Holmes has said, what is reasonable depends upon the strong preponderant public opinion at the time in question. The anti-trust laws were not intended to put a strait-jacket on an expanding universe.

I welcome the coming of the T.N.E.C. investigation, because I believe that there will emerge from it some better liaison between the government and industry. We need some common ground where government and business can meet and work out the solution of these problems upon a friendly and coöperative basis and not in purely adversary and antagonistic proceedings—in senatorial investigations or in the courts. I am sure that we shall find that many

[1] 246 U. S. 231.

[2] 263 U. S. 403.

[3] 288 U. S. 344—note particularly Mr. Justice Hughes' statement page 374: "The fact that the correction of abuses may tend to stabilize a business, or to produce fairer price levels, does not mean that the abuses should go uncorrected or that cooperative endeavor to correct them necessarily constitutes an unreasonable restraint of trade."

of the economic means of stabilizing production and employment and making the most efficient use of all our national resources will be such that they can be attained only by voluntary coöperation and not by legal sanctions.

Such a common meeting ground is supplied in England by the Board of Trade. Such a meeting ground in this country has already been suggested tentatively in the form of a Bureau of Industrial Economics.

If an agency of that character is to be created, I should like to make the following suggestions as to its general nature and the work it might perform. I do this with hesitation, because our knowledge and experience are not sufficient to enable us to say with certainty what is desirable or practicable. But the necessity for evolving methods which will enable us to obtain a more stable and continuous flow of production and employment is the very reason why the creation of such an agency is being considered and why suggestions, even though tentative, should be made.

In the first place, such an organization should be founded upon a wholly new and different psychological approach. It should start with the idea that its function is to make an affirmative and helpful contribution to business activity and not to occupy a negative and prosecutor relation toward it. It should study those industries where wealth, far from being concentrated, is being dissipated and destroyed. It should investigate those chronically depressed industries where competition runs riot and workmen starve, as well as those successful industries where capital makes a profit and life, on the whole, is tolerable and decent. It should start with the idea that the most important thing is that business should be encouraged to stabilize the rate of production and employment.

If the attainment of that end requires permitting a considerable degree of coöperation, it should not shrink from permitting such coöperation. Many—perhaps most—of the means may be of such a character that they will not lend themselves to enforcement by law at all. We shall have to rely on voluntary coöperation in order to carry them out.

To that end, it should study: (1) how to minimize swings in employment—seasonal—cyclical—or for any reason whatsoever; (2) what forms of industrial organization would make for the greatest efficiency in time of war or other emergencies and whether some of the same methods might not also be useful under some conditions in time of peace; (3) whether programs might not be voluntarily arranged between different industries—or between different companies in the same industry—for a continuous flow of orders and the avoidance of peaks and valleys of over- and under-activity (as

for example long-term contracts which would justify manufacturers in continuing to operate and accumulate inventory during dull seasons, relying upon the certainty that this inventory can be profitably disposed of later).

It should study sound methods of business administration. It should affirmatively recognize that a demoralized and depressed industry is an anti-social, decivilizing influence, and that the public has just as vital an interest in industrial solvency as it has in agricultural solvency.

It should be just as interested in reducing the present frightful death rate of corporations as the S.E.C. is interested in preventing their illegitimate birth. To that end it should study: (1) proper methods of accounting; (2) the elimination of waste; (3) standardization and simplification—to avoid intolerable complexity of products and of business methods; (4) industrial forecasting—to make available to all the methods which are already used by the most efficient private companies; (5) statistical services—prompt and timely—showing inventories, probable demand, ratio of operation to capacity, etc., so that industry may adjust itself intelligently to existing conditions, and capital may not be lost or diverted from useful purposes to wasteful and unnecessary ones.

It should study whether too great instability of prices does not result in speculative buying, which makes impossible stability of employment. And in this connection it might consider whether it is desirable for the government to use the great weight of its purchasing power to beat down industrial prices during times when "disorderly markets" clearly exist, thus tending to dry up demand by creating further uncertainty in the minds of private buyers.

Such a body should not be exclusively governmental in character. It should have power to enlist, for special purposes—with or without compensation—men in private life who have special experience and capacity in any field.

It should be able to consult and coöperate with trade associations, labor unions, engineering societies, schools of business and economists, and with committees of outstanding men in any walk of life, such as the committee of business men constituting the Business Advisory Council of the Department of Commerce. The government could easily get the coöperation of the best brains in the country upon that basis.

Finally, I hope that something may be done about removing the brakes upon industry resulting from the present notorious uncertainty of the anti-trust acts—not by codification, but by clarifying administrative rulings. It is easy to put the brakes upon industry. The difficulty is to make industry go.

I have been a member of the Department of Justice. I have been associated with the Federal Trade Commission. I know the timidity with which Washington shrinks from taking the responsibility of telling men that they can go ahead. I think it is time that this timid attitude should be abandoned. The government should not be afraid to give advisory rulings to industry. It can always retain the right to withdraw its approval the moment that it discovers that a program is working badly or that its confidence has been betrayed.

Industry is operating the great productive forces on which society depends. The government should recognize that fact. It is ridiculous for the government to be afraid of business. That is an affectation inherited from earlier days. The government can stop anything that industry does. The problem is not to stop industry but to get it to go ahead. And industry will go ahead only as the result of incentives—and not by compulsion. The unemployed cannot be put to work in any other democratic way.

DISCUSSION: PUBLIC POLICY TOWARD CONCENTRATIONS OF ECONOMIC POWER

CHAIRMAN BURGESS: We come now to the period of discussion, and sometimes questions are asked. I note that all the speakers who remain here are lawyers, who are accustomed to cross-examination. For some extraordinary reason, the only speaker on the program who is not a lawyer has fled.

MR. H. SCHERBAK: May I suggest that monopolies might be more intelligently regulated, if we could obtain a better "visualization" of the various phases of their problems. The structural lines of any kind of industrial combination can be laid down on a blueprint, showing departments, problems and the controls which affect labor, materials, prices and markets. Likewise, it would be easy to make such an analysis of governmental departments. Without such "visualization" of our economic machinery we will never get it into working order.

MR. GEORGE EDWARD CROTHERS: It is just thirty years since I was privileged to present my views on the revision of the Sherman Act to the Seth Low Commission appointed by Theodore Roosevelt. At that time I stated that a particular evil should be carefully defined before it is made a criminal offense. Subsequently President Wilson appointed Judge Clayton to study this same thing, and he reached the same conclusion. I discussed the subject with him and he made a report, emphasizing the importance of the proposition that criminal laws should be made by Congress and not by bureaus or deputies in the Attorney General's office, or in any other executive department.

Let me give an illustration. Mr. Ford and Mr. Chrysler are accused of a high crime, and what is it? Financing the sales of their own machines! If that is wrong, could we not state that a man who finances his own machines through a subsidiary, for their sale throughout the country, must register that subsidiary as a general finance concern? That would require it to treat all automobile manufacturers alike. Who wants to manufacture automobiles and become subject to criminal liability for doing something, which no law has ever declared to be criminal, and which these very gentlemen who are enforcing it do not dare suggest that Congress define as criminal? I think this very thing, now being accomplished by consent decree, which is in the nature of a blackmail consent, could be and would be made unlawful if the Attorney General would only suggest it.

It is a very simple matter. Each offense must be defined by itself. Let us take them up one by one and supplement the Sherman Act, which all of us agree is in principle correct.

MR. ARNOLD: May I make an explanation? I quite agree with the last part of the last speaker's remarks; however, he is not correct in saying that the indictments were for financing cars. The indictments were for the use of coercive and illegal measures to compel dealers to select favored finance companies. They went into a great number of coercive practices, which I do not have the time here to discuss. The indictments did not have anything to do with a statement that a man cannot finance his cars; and the consent decree is a voluntary effort on the part of Ford and Chrysler, without admitting their guilt, because, of course, we do not ask them to do that, to change the competitive conditions so that the pressures will not be upon the finance companies and the manufacturers to go through similar practices.

It is perfectly true that the violations of the Sherman Act are more like traffic offenses, I think, than they are like picking pockets, and I have been careful always to make that clear; and it is also true that if one industry turns buccaneer, all other industriees must follow. In a fight without a referee, everybody puts on brass knuckles. The referee has been absent, but it is not correct to say that this indictment of Ford is an indictment for anything other than the common, ordinary violations, which we have all known, of the Sherman Act.

MR. CARROLL L. WILSON: I am not a lawyer, Mr. Chairman, but I should like to ask Mr. Arnold one question solely for information. My question is this: Why has the anti-monopoly tradition been peculiar to this country? Why has it been so conspicuously absent in England, shall we say, at least within the last generation?

MR. ARNOLD: If you will read an excellent book, Miriam Beard's *A History of the Business Man,* you will see that the monopoly question has been recurrent in all commercial eras. I think the monopoly question in England has not arisen under a particular act such as the Sherman Act because concentration of power did not move so fast in England, but you can draw your own conclusion.

So far as the monopoly question is concerned, if you take the doctors' suit, for instance, in 1918, you find that the English courts decided almost identical conduct on the part of the British Medical Association, conspiracy in restraint of trade. We got all our common law notions of conspiracy and restraint of trade from England, and the Supreme Court has stated that the Sherman Act is declaratory of that common law.

MR. WILSON: In other words, we are just growing up.

MR. ARNOLD: Well, the size of the country and the different type of financing have created a different method of handling these problems.

MR. EDWARD F. MOORE: I wonder if I might ask a question. Perhaps Mr. Arnold would be interested in saying a few words in reply. Assuming that the general intent of the Sherman Anti-Trust Act was to maintain the greatest possible production, distribution, and consumption of goods and services for the American people, is it not true that in recent years two of the greatest offenders against the spirit of this act have been the federal government and certain labor unions?

MR. ARNOLD: I know of no single industry which does not offend to some extent against the act and complain about other industries. I have indicated with respect to labor in building (I can not talk about labor in general) that if I were a labor leader today, I would not want to cut down the hourly wages and see it swallowed up by contractors ganging up in these cities, by identical bids and by various legislative policies. For instance, you speak of the federal government—recently in Maryland there were twenty-one identical bids for cement given to the Treasury, and one low bid; and the low bid was prosecuted under the state act, prosecuted criminally, following the Miller-Tydings Amendment.

I think that you can state the situation as follows: for forty years we have had purely ritualistic enforcement of the Sherman Act. As Judge Ransom has said, we have kept the ideal alive, and that is all we have done. I am not throwing moral bricks at the various people in that uncontrolled situation. It has been a matter of self-preservation; nevertheless, I think that by adequate enforcement we can produce a situation in which these conflicting policies will no longer exist, or, if they *are* necessary, only in particular industries in which they can be recognized and legalized and not spread beyond that industry. For example, the Capper-Volstead Act allows farmers in general to combine and fix prices. If we examine factually the situation in Chicago milk, where a number of indictments have just been returned, I can conceive that in the interest of orderly marketing we might allow certain combinations; but I do not think that the situations in Chicago and Detroit are sufficiently similar to apply the same formula. Judge Ransom was kind enough to read part of my release on the Detroit situation, so my answer to your question is that everybody, in the absence of the referee, has been protecting himself in this way; and that is true.

Mr. Moore: I wonder if it would be proper to state the two particular examples that were in my mind in asking that question. I was thinking of the offense against the spirit of the anti-trust laws in organizing the farmers of the country to reduce production and raise prices, thereby preventing the mass of consumers having what they otherwise might have; and with regard to the labor unions, I think the inference is quite obvious, but an outstanding example might be cited of the building trades unions, which maintain wages of about three times the level of those in England.

Mr. Arnold: That is a statement of Mr. Wallace's policy which I would not assent to, but I think we would go far afield in debating it.

Mr. William Tobias Butler: I should like to answer Mr. Moore and state that, if we had not followed a principle of laissez faire in the industrial field, which permitted the corporate empire to grow into such power that it dominated prices and secured many favors in the form of tariff and other matters, we would not now have to protect the individualistic farmer and the laborer. Labor unions have followed the course of empire. As corporations grew in size, and as three hundred corporations combined in one holding company, naturally the bargaining power of the individual laborer was lost. In order to offset the corporate power of corporate management, labor had to unite. Now, I am opposed to both tendencies. I do not believe in putting the onus on the human being and bowing and scraping to the artificial person, who has been endowed with the dignity of a ritual by our corporate folklore.

Mr. MacMillan (Philadelphia): I should like to know whether the application of the decrees is likely to have any effect on the prices paid by the purchaser of cars on the instalment plan.

Mr. Arnold: I think so; that is, in any situation of financing, the ordinary man cannot figure interest. I do not believe that you and I in most instalment contracts really know what interest we are paying, and we now have the great manufacturers putting out a plan which will be examined by the Department of Justice and I think that we may assume, though we do not have the plan yet, that it will be the fairest kind of plan, and the cheapest possible financing. That does not mean that the loan shark is necessarily eliminated, but it means, in so far as advertising is concerned, that the loan shark will be eliminated, and there will be enormous public pressures to eliminate him. It also means that in carrying out that objective Ford and Chrysler will not be favoring one particular finance company; that is, that they will not be growing in all directions into the

financial field as a sort of octopus. It seems to me that they deserve great credit for doing voluntarily a thing which goes beyond any present precedent in advertising, because I know of no decisions which prevent one man from advertising his own particular company. In the consent decree policy, however, we are making it a rule to have no more perpetual consent decrees. After a limited period of time this whole situation will be reëxamined to see if the provisions of this decree are actually working out. I think that the permanent consent decree is something that no man today is wise enough to draw and it is contrary to my own idea of taking up situation by situation, because, of course, situations change.

Mr. A. H. Reede (Harvard University): Although Dr. Wolman has left the room, I should like to make one or two remarks with regard to his paper. I do that in spite of the very respectable tradition which indicates that we should not speak of the dead, nor raise questions with regard to speakers who have disappeared from the room. Since it will be a part of the record, I do not think it will do Dr. Wolman any injustice.

Professor Chaddock once remarked that no person's reasoning, reckonings or conclusions were any better than the statistical underpinning which he used. I think the statistical underpinning of Dr. Wolman's remarks would bear a little analysis. In the first place, he argued that the rate of unemployment in England and in the United States had increased to a remarkable extent and in proof of that he submitted figures with regard to English unemployment, going back into the nineteenth century, and with regard to American unemployment going back to the middle twenties.

He asserted that the statistics were sufficiently comparable to allow him to do that. I think that he was in error. I think that he more or less hinted that he was in error, when he remarked that unemployment is today defined in a different manner than it formerly was. People now count themselves unemployed who years ago would not have so counted themselves. It is also true that people now have an incentive to register the fact of their unemployment, because today there is in existence a system of unemployment insurance on the one hand, and unemployment relief on the other hand; in other words, we have more people indicating the fact of their unemployment. We are better able to count the unemployed. For that reason I do not think the extent of increase indicated by Dr. Wolman has actually occurred.

In the second place, he argued that wage rates had increased particularly in recent periods. In doing that he used figures for real wage rates. Now, real wage rates are figures which take into account not only the change in wages but also the change in the cost of living. It seems to me indefensible statistically to use real wage rates for the purpose which Dr. Wolman had in mind. What he wants to demonstrate, it seems to me, is that there is some relation between labor and unemployment, but the only possible relationship could be between labor costs as such and other costs of doing business. The cost of labor to the employer is not measured by real wage rates; it is measured by actual money wage rates. Dr. Wolman said that real wage rates for factory employes had increased 45 per cent since 1929, but I do not think that he would assert that money wage rates have increased 45 per cent since 1929. How much of that increase is simply a change in the cost of living? That is the point which I should like to raise at this time.

Mr. Simon Whitney (Edie & Company): I meant to speak about Mr. Gordon's discussion, but I want to combine with it one remark on the last speaker. It does not seem to matter whether you mention real wage rates having risen or divide it and say money wage rates have risen 10 per cent and the price the employer has to sell at has decreased 20 per cent.

Mr. Gordon's proposals were based on the theory that in 1929 excessive competition forced us into our depression, and, as he put it, caused losses to business and drove even some of the strongest companies into bankruptcy. How he reconciled that with income tax returns which showed that in 1928 corporation profits reached a postwar peak and that in 1929 they reached a still higher peak than in 1928, I do not know.

Mr. Gordon: I do not think that I intended to say quite what Mr. Whitney has quoted me as saying. All that I had in mind in raising the question was this, that we have heard some of the speakers today speak as though competition to the very maximum possible is desirable. I have grave doubts whether that is the fact. I think we are constantly curtailing the extreme forms of competition, because we find that they are socially undesirable; and I think that as we search for means by which we may stabilize production and thereby render more continuous the employment of labor, and as we try to curtail the uncertainty of life, which is the principal grievance that labor has against our present form of society, we may have to consider ways by which competition can to some extent be curtailed, leaving at the same time enough competition to give us those objectives which we really want, reasonable prices, reasonable service, and the technical advances which competition is supposed to bring.

Chairman Burgess: I am afraid the time has come to adjourn. Let me express your thanks to the speakers and to those who have spoken from the floor, because that is an essential part of our meeting.

PART III

INDUSTRIAL ORGANIZATION AND THE AMERICAN IDEAL OF LIVING

INTRODUCTION *

THOMAS I. PARKINSON, *Presiding*
President of the Equitable Life Assurance Society

MEMBERS and guests of the Academy of Political Science: This is our Fifty-eighth Annual Meeting. Because of my long association with the Academy and with the University which nurtures it, I am conscious of the peculiar honor and privilege which I enjoy tonight. The Academy has long provided a forum for the orderly discussion of major issues of the day. That forum provides a meeting ground for men active in scientific research, public service and business management. The problems of political science grow more complex and important as our population changes and government expands its functions. There never was a time in the history of our country when public officials administering government and managers administering business were more in need of the help of scientific research.

The political scientists have in recent years taken the emphasis off reason and logic in their research and, following the pure scientists, have emphasized observation and analysis of the facts. This has neither lessened the difficulties of the practical administrators nor lightened the responsibility of their academic friends. Many of the men on our program at this meeting have been leaders in their academic days in emphasizing the *factual approach* to the problems of law and political science and are today realizing in important government positions the opportunity of applying the results of that ap-

*** Introductory Address of the Presiding Officer at the Third Session of the Annual Meeting.**

proach. But the facts are elusive and not easy to interpret. Moreover, while pure science has demonstrated the advisability of emphasizing observation of facts, experiment and action, there are still situations in which pure science admits values to be derived from reason and logic. If this be true in pure science, it is certainly more important in political and social science, which involves so much of the human element. Principle, experience, reason and logic still have their place in defining and determining political and social issues and cannot be wholly rejected by the advocates of the factual approach.

Admitting that the facts are essential, it is a difficult scientific task to locate, to identify and to organize them. We realize that it is not possible to assemble the facts of social and political development with the same degree of completeness and objectivity that the exact sciences have achieved, but the isolation of fact from opinion with logical rigor is not too much to ask of men who take the leadership in defining our issues or in offering formulas for their solution; and this is particularly true of those who hold distinguished chairs in law and political science in our great universities. Their predecessors were the guides of practical men, when fundamental principle and pure logic were accepted as providing the solution of our problems, and now when the facts are emphasized, we have need of more, not less, of contribution from scientific research.

Various tools are required to locate, to identify and to interpret the facts. Sometimes it may be the rules of legal evidence, sometimes the principles of historical evidence, sometimes the basic processes of logical thinking. Sometimes it may be necessary to determine not merely what was done but why it was done. The scientific handling of the facts requires unflagging patience and industry, coupled with real scientific humility and a realization that most of the issues cannot be completely isolated but must be considered in their relation to life as a whole.

We have at the moment a great opportunity to deal with our political and economic problems. Congress at its last session created an important investigating agency under the name of the Temporary National Economic Committee. This Committee consists of three members of the Senate, three members of the House, and representatives of six executive

departments and agencies of the federal government. The Committee is directed "to make a full and complete study of monopoly and the concentration of economic power in and financial control of production and distribution of goods and services and to determine without limitation the causes of such concentration and control and their effect on competition." The Committee is also directed to examine "the effect of the existing price system and the price policies of industries upon the general level of trade, upon employment, upon long-term profits and upon consumption." Finally, it is given the mandate to survey the effect of tax laws, patent laws and the like "upon competition, price levels, unemployment, profits and consumption" as well as to "investigate the subject of governmental adjustment of the purchasing power of the dollar so as to attain the 1926 commodity price levels." This is a broad power and a great responsibility. It has been interpreted as including not merely monopoly and competition but the whole field of business organization and procedure and the relation of government to business.

Like our theme of this evening it brings to mind the fact that the American way of living and working runs through the whole problem of the relationship of government to the individual and to his business interests whether conducted individually or under the corporate form of organization.

As we contemplate the task that lies ahead, we must emphasize the importance of historical fact and sequence, as related to the framework of public policy, for here, as in other instances affecting the development of law and economic policy, the Committee confronts the task of relating the acts of public authority to the interest of the individual, the group and the whole community in a way that will reconcile contemporary interests and objectives, with long-time interests and objectives.

The difference between men's interpretation of the past and present and their aspirations for the future is conditioned by the times. There are times of great tension in world affairs, in national and local affairs; and there are times of relaxed and serene outlook. It is probably true that periods of apprehensive challenge alternate, in some obscure fashion, with periods of confident coöperation. Those whose memories review the first third of this century are all too aware of these transitions—from the ill-disciplined assurance and high pressure of the first decade through the bewilderment, fatalism and idealistic hope of the second, into the strange mixture of arrogance and relaxation of the third, and then, the hopelessness and disillusionment of the fourth. Is it any wonder that we should be traveling once again and at an accelerated pace some erratic and baffling cycle into a zone of high tension, nervous challenge and disturbing doubts? What institutional systems could ever have been contrived by mankind that would have stood wholly unshaken through all of the stages of this ceaseless reordering?

It is in these periods of high tension that men differ most sharply in their notions of their interests and the safeguards thrown around them by law and government. It is in these periods, too, that zeal to correct such notions and to redefine rights is most likely to involve lack of patience and of cooperation. And yet, patience and coöperation will be the outstanding features of the present inquiry, if a lasting contribution to "The American Ideal of Living" is to result. Coöperation is possible only when rational processes are at work, and rational processes will operate only when we trust each other. Such coöperation and mutual trust imply a composure, such as that of men who do not flinch in the face of formidable danger, and such courage is a rational process which never can be found in combination with the desire to destroy for the sake of destruction. The calm insulation of the judicial mind is something at which fun is sometimes poked by the irreverent; yet that serene freedom from ephemeral and irrelevant considerations and pressures has been the finest fruit of mankind's most enduring ages, whether in the guise of the edict of a praetor, the treatise of a medieval canonist, the opinion of a chancellor, or the earnest effort of our contemporary jurist (beset with difficulties at least as great as any that confronted his predecessors) to isolate fact from opinion.

Upon the shoulders of the members of the National Economic Committee, the Congress of the United States has placed a great responsibility, that of analyzing the principal factors that affect the distribution of the goods which men produce and the services which they exchange. The task has been entrusted to this jury of distinguished gentlemen at a time when men's feelings are tense, and their conception of the world around them distorted with the imagery of fear. Great

tasks evoke great qualities—or produce great tragedies. The courage to evolve and to sustain with unremitting vigor and restraint the procedure which will isolate facts and elucidate their relation must animate those who guide this memorable inquest if it is not to be a strange and passing incident. They are all men capable of comprehending that the exploration and definition of public policy is a process of rational and patient analysis without ever losing contact with the historical framework of factual and objective reality. How far they will plan to go in their mission of conciliation of present and future interests and objectives, it is their grave responsibility to decide. Their unhampered freedom, evenhandedness of procedure, and ripeness of reflection will assure their full and honorable satisfaction of their responsibility, whatever the fate that may be in store for the conclusions which they submit to the Congress of the United States.

Remarks by the Chairman

Mr. Thomas I. Parkinson: The migration of talent from region to region in this country is agreeably demonstrated in the personalities of the two gentlemen whom I have the honor of presenting to you tonight. One is a man who as a youth left New England to test his chances of achieving responsibility in one of the corners of the country abounding in elbow room, natural resources and widespread disposition to take men to be worth solely what they themselves have to offer. The other is a man who, born in the Southwest, came to the East first as a student and teacher, then as a representative of his state, and then as an officer of the federal government, alert to apply an objective and critical mind to the practical problems of government. He has rendered great public service in his effort to balance the federal budget, has carried heavy responsibilities in the business world, and now, by virtue of what we hope will be a short-term intellectual loan to our Canadian neighbors, he is Principal and Vice Chancellor of McGill University. I have the honor and the privilege of presenting to you, Dr. Lewis W. Douglas!

INDUSTRIAL ORGANIZATION AND THE AMERICAN IDEAL OF LIVING

LEWIS W. DOUGLAS
Principal and Vice-Chancellor, McGill University
Former Director of the Budget and former Congressman from Arizona

MR. CHAIRMAN, members of the Academy, its guests, and Senator O'Mahoney: The person who has been introduced to you this evening by your chairman is wholly unrecognizable to the speaker. (Laughter) The only defense which he can make, in so far as the title of "Doctor" is concerned, is that he has no practice but much patience. (Laughter) He acknowledges, Mr. Chairman, with gratitude, the invitation to be here this evening and the hospitality which you on behalf of the Academy are extending. He is glad, too, to be on the same platform with one whom he has always counted to be his friend, Senator O'Mahoney.

The Senator's presence reminds me of a conversation which President Roosevelt — President Theodore Roosevelt (laughter)—was reported to have had with Carl Akeley when the latter had returned from one of his trips to Africa, bringing with him, so I am told, a boatload full of large and ravenous lions.

When Akeley told the President of his gift to the United States, the President replied, "Carl, I wish you would give me those lions." And when Akeley asked the purpose for which the President wanted the lions, Roosevelt answered, "I would like to turn them loose in the Senate." (Laughter)

It is said that Akeley responded with the question, "But, Mr. President, don't you think they might make a mistake?", to which, so the story goes, Roosevelt replied, "Not if they stayed there long enough." (Laughter)

I should like to say that had Senator O'Mahoney been in the Senate, when President Theodore Roosevelt was in the White House, Senator O'Mahoney would have been like David in the lions' den. (Laughter)

(Mrs. Lewis Douglas remarked: "Did you say 'David'?") Wasn't it David? Oh, Daniel! (Laughter) I knew it was Jonah that had been in the belly of the whale. (Laughter)

Bryce quotes a character in one of Disraeli's novels as saying: "Few ideas are correct ones, and what are correct ones no one can ascertain; but with words we govern men." This is a not unrealistic definition of the practical workings of democracy. Depending on the time and tide and circumstances of human affairs, it is either an infallible guide or an unfaithful index to human behavior.

It is probably true that the views which each one of us holds from time to time, the opinions which each one of us expresses, are colored by the environment from which we come, the events which mold our lives, the personalities with whom we have been associated, and the general state of physical well-being which each one of us may enjoy. Some there are, however, who are disposed to modify their views according to the available evidence. These are the ones who forge each sentence in the teeth of irreducible and brute fact. Though I should like to be numbered among this group, I do not profess to have attained that necessary degree of objectivity.

The subject which the Trustees of the Academy have chosen for tonight is "Industrial Organization and the American Ideal of Living". This is, indeed, a mouthful, and I frankly confess that I have been struggling for many months to digest it. It has not yet, as you will soon discover, been successfully assimilated.

But I venture to assert that unless we all follow the evidence rather than our prejudices, unless we form new opinions in the light of facts rather than stubbornly cling to the unsupported traditional views of our fathers, views which may have been appropriate in the light of circumstances then existing—unless we are prepared to do this, the best features of our American past may soon become mere landmarks slowly disappearing from view below a distant horizon. And I will venture to suggest, too, that we must not ignore events on those horizons across the seas, for they may play a dominant rôle in molding the course of public policy at home.

The topic so carefully and, from my point of view, so mischievously chosen by your Trustees implies the wish that both Senator O'Mahoney and myself assume the difficult task of describing a constructive program designed to preserve what is called "the American ideal of living". Thus, first, we must define what "the American ideal of living" actually is. This task is a particularly troublesome one because for the ordinary person it is far easier to abuse a devil than to praise a god; it is far simpler to tear down than it is to set up; it is easier to burn than it is to build. The task is particularly difficult, too, because it embraces the many currents which have formed the main stream of American life: the social, the political, the economic.

Lord Bryce has pointed out in *Modern Democracies* that people ordinarily do not attempt to establish a particular sort of social organism, to cultivate a certain kind of political soil in which it may thrive, and to provide a predetermined variety of economic host on which it may live, merely because they have become enamored of some broad philosophical conception of society. On the contrary, from the evidence which he produces he concludes that changes in the social order are more frequently adopted because in them people see a remedy for the abuses which they consider themselves to be suffering, and bcause in them they have a vision of redress against the grievances which they think themselves to be enduring. This rather realistic approach, slightly modified, will be the guide in dealing with the subject selected for discussion this evening.

Certain views that have been alternately ends and means, cause and effect, have been steadily flowing in the main channel of American thought since the founding of the Colonies, despite the fact that some of them have from time to time formed strong cross-currents and powerful back eddies. An identification of these dominant ideas may perhaps give us a perspective of the general nature of this thing which we call "the American ideal of living".

The first of these, I should say, has been the existence of a continuous faith in the omnipotence of education, an unswerving loyalty to the view that in education is to be found the only workable basis for a democratic organization of society.

There has come down to us through a long line of antecedents a belief in the existence of opportunity; a conviction that for him who is competent there awaits a significant position in the life of the community; that honorable work well done will be rewarded by material well-being.

We have inherited, too, an abiding confidence in the virtues of the democratic process. Its lineal descent goes back to the days of Colonial government, to the influence of France and Rousseau. It was expressed in the Declaration of Independence. It was the central thought running through the Constitution, and particularly through the Bill of Rights. It has been reinforced by the existence of a great frontier of free lands, of a wealth of natural resources, and by the promise, for a while fulfilled, of the opportunity to enjoy the privilege of possessing property. "The Land of the Free and the Home of the Brave" is the proud title that we have so frequently and so consistently given to our country. This is the bequest, still not wholly dissipated in our minds, from the pioneer period of our history.

I should say, too, that, indistinct as it may now appear to be, obscured as it may have become by the successful activities of political pressure groups, there has been a quiet but persistent emotional fidelity to the Jeffersonian idea of special privilege for none; equal opportunity for all.

And finally, I should say, there has existed a universal distrust of an excessive amount of power, regardless of whether that power is vested in private or public hands. This conception goes back for more than two hundred years. We inherited it from the Independents of England whose views were transplanted in the frontier soil of the New England Colonies by our Puritan forefathers. It appears frequently in Colonial history, and finds expression in the philosophy of Jefferson, the political actions of Jackson, the somewhat mixed reform movement of the last quarter of the last century. A growing apprehension of the amount of private power that has been increasingly concentrated in corporate enterprise is disclosed by an examination of the platforms of the two major parties which have dominated our national politics from the close of the Civil War to the present day. Since 1880 in the platform of the Democratic party, imitated four years later by the Republicans, there are to be found ringing denouncements of trusts, combinations, monopolies and corporate abuses. The same popular views were manifested by Grover Cleveland, by the inconsistent public acts of Theodore Roosevelt, by the "New Freedom" of Woodrow Wilson. They are observable, too, in certain features of the elaborate program known as "The New Deal". This belief has been most sharply silhouetted during periods of discontent and economic depression. It has frequently been forgotten when the discontent has subsided and depressions have been succeeded by cycles of prosperity. And in many of the periods in which it has been most vigorously pressed, public power has been invoked as a remedy for what was considered to be an excessive amount of private authority.

It is obvious that these dominant beliefs are complementary one to the other. They are homologues of the same compound. In a sense, they are means to the same end, an end which is revealed by the fact that the democratic idea is common to them all.

Thus the traditional course of American thinking and emotion has been directed toward the preservation of democratic society, *democratic in its political structure, democratic in its social aspirations, democratic in its promise of opportunity.* Derived in part from the ideas of the European reformers of the seventeenth and eighteenth centuries, it flourished under the fertilizing influence of American character; it was nourished by the immense expanse of a free continent where opportunity for economic independence beckoned to whoever would answer the call. Here on the frontier there was absorbed much of the discontent that in periods of cyclical depression prevailed throughout the settled part of the country.

There can now be observed many modifications in the political, economic and social structure which seem to demand an alteration of means if there is to be a continued existence of the central fact of our history.

We have quite fittingly placed a high value on education. But, as was only natural in a nation chiefly concerned with the conquest of a continent, it has tended to become more and more vocational in substance. Thus it has more and more taught the "hows" instead of the "whys", and has resulted in a national disposition to do rather than to think. Vocationalism has a meaningful place in an educational system, but not at the expense, the cost, the sacrifice of cultivating a people with a capacity to think, and to distinguish between the true and the false, for this is one of the cornerstones of the democratic structure.

The disappearance of the frontier over which the tide of western migration has rolled, and in which at least a substantial number obtained a stake for themselves and their children, the unarrested qualitative and quantitative dissipation of the nation's soil, the increasingly heavy burden of taxation on the middle class (indeed, all classes), the technological changes which, with the grim inevitability of the Greek tragedy, have crept into our industrial processes, the forms of our financial institutions organized for the purpose of supplying long-time capital to huge enterprises, the modifications in the nature of property itself and the methods by which it may be acquired, and the slow migration of the population to great congested metropolitan areas have operated cumulatively to diminish the opportunity for the individual to become independent, to reach a significant and honored position in the life of the community, of the county, of the state and of the nation. They have had a profound influence on our values of living. They are in part, it seems to me, the sources from which there springs the current demand for security. But we will misunderstand its nature if we permit it to become for opportunity a complete substitute instead of merely a supplement. For, in the final reckoning, security can exist only concurrently with opportunity. Hence one of the greatest human purposes of the day should be the re-creation of a faith in its existence, for it is this faith which nourishes self-reliance, and it is self-reliance which provides one of the most effective defenses of free institutions.

For more than half a century, the view that special privileges should be granted to none has been undergoing a series of severe and damaging shocks. Vast portions of our public domain have been granted outright to corporate enterprises. Pressure groups have besieged the halls of Congress—and, I should add, successfully—seeking, at first, tariff subsidies, then different varieties of grants, grants different in form but essentially the same in principle. And finally, the injustices that irrevocably accompanied our policy of extreme protection, and the impoverishing consequences on large portions of our rural communities, have been persuasive on government to provide a vast series of additional public subventions.

In a society so subsidized by public power and personal control of the common purse will there not some time be relinquished a degree of individual freedom which may constitute a real menace to the existence of democratic institutions?

I have said that we have inherited a passionate belief in the virtues of the democratic process. But what, we should ask, has happened to this process? Is it democratic in the sense that the expression of public will dominates public policy? Are the political parties—indeed, for that matter, have they been for the last seventy years—organized for the purpose of performing a national service? Or has their primary objective sunk to the level of devising those methods that will, so they hope, successfully elevate them to, and maintain them in, positions of public power? Is public opinion today synonymous with the public will? Has the democratic process been degraded and corrupted during the last seventy years by the ever increasing disposition to exercise the authority to promise, to grant, or to withhold, a vast variety of special privileges in return for ballots in the polling places? Has fear of consequences been persuasive in directing the citizen's observance of political loyalties?

The answers to these questions go to the very marrow of the entire political theory of liberal democracy. And they indicate an inseparable association established by experience, if not by logic, between sociology and psychology and the theory and practice of politics and economics.

And now, let us ask, is the prevailing distrust of an excessive amount of private power justified by a review of our industrial history? It is safe to say that the areas in which huge corporate enterprise operates have been increasing, that corporate size is more common today than it used to be, that the division of labor between individuals has been growing, whereas the division of labor between corporate institutions has been diminishing. That is to say, horizontal mergers, and thus the growth of large, far-flung, highly diversified corporate enterprise, have been supplemented by vertical combinations which *seem* to increase the diversification of activities and the magnitude of operations under one control.

These great industrial units are clearly inimical to the public interest when they either produce an outright monopoly or encourage and establish monopolistic practices all of which have as their purpose the joint administration of prices by

private power. They create an industrial situation unresponsive to cyclical and secular price trends. Thus they increase unemployment and vastly intensify the suffering which characterizes periodic economic depressions. Even in eras of prosperity they constitute a barrier to the distribution of wealth and an interference with its production and its exchange.

Short of this clearly undesirable limitation on the development of the huge industrial corporation, the evidence is complicated, confusing and not convincing. Mere size does not necessarily mean monopoly. There can be and, indeed, there is intense competition for markets between industrial giants. A discussion of the large corporate entity, of the alleged benefits derived from it, and of the grievances—social, political and economic—ascribed to it, would take us far into the night and would lead into an intricate debate aimed at a definition of precisely what it is we mean when we use the phrase "big business".

I should merely like to suggest a series of questions: Is industrial corporate hugeness a natural and inevitable result of the introduction of the machine and of the utilization of power? Was Karl Marx correct in forecasting this particular phase of development in a capitalistic society? Was the American business man correct in worshiping, as he has worshiped, mere size? Has he been unwittingly and in a spirit of good will the most effective collectivist of them all? Is there not, perhaps, a fallacy in his efforts to develop his business enterprises into great affairs that provide a variety of services, that manufacture a vast array of more or less unrelated products and whose tentacles extend from coast to coast and beyond the seas? Is this sort of structural change wholly inescapable? Is it inherent in the progressive development of industrial technique? Or is it perhaps a synthetic consequence of the growth of financial institutions, of the cultivation of a certain type of financial market place? Is it, perhaps, the shadow cast by the many special privileges, immunities, subsidies and rights which public authority until recently has so generously bestowed on business? Is it not tenable to suggest that it may in part be accounted for by the legal investiture of corporations with many of the important rights, enjoyments and privileges vested under the law in individuals? Have monopolistically administered prices of services and of materials necessary for further fabrication had the consequence of persuading corporate consumers to undertake the production of them for their own use, and thus to enlarge the sphere of their operations as a defensive measure against monopolistic practices? Is there not a very great distinction to be drawn between mass production on the one hand and, on the other, highly diversified, unrelated—perhaps one might almost say, collective—production?

I intend these questions to be provocative because they are intimately connected with the proposition frequently expressed that big business begets big labor, and that both beget big government; that private abuse begets public abuse; and that private power begets public power.

There are those who would dismiss the conception of the free market as the pivotal point of industrial organization, on the grounds that it is obsolete, that it can prevail only in an environment suitable to small-scale artisan enterprise. There are those who hold the view that the appropriate "dynamic price making policy" is represented by aims of industrial executives to supply what the consumer potentially wants and can pay for. But this opinion, it seems to me, is merely good advice to the business man as to how he should employ the free market. For although this price policy may be conceived in the executives' offices, it can be born only in the free market place.

I understand that there are some who claim that certain industries should be cartelized because they are suffering from over-competition. But I should like to ask why they are suffering from over-competition. Is it because of some idiosyncrasy which they alone possess? Is it because there is a natural law (if there be any such thing as a natural law as distinct from a law of nature) which governs these particular industries? Or is this affliction of over-competition due to other conditions arising out of factors such, for example, as tariff protection, or the appearance of synthetic competitive substitutes? Is the policy of cartelization designed to protect invested capital or consumer interest? How do the employees of the nation, in their capacity as employees and consumers, ultimately fare under this policy?

Excepting the enterprises known as natural monopolies—utilities—and perhaps a few which may qualify as temporary hostages to emergency conditions, I suggest that, as a general rule, business enterprise is capable of passing on to the nation technological developments, production efficiencies, distribution improvements, of responding to scientific discoveries, to secular and cyclical changes, and of minimizing the consequences of depressions, only when it is directed by the influence of the free market, a place in which men, unrestrained by prices administered either by private agreement or compulsory public order, are free to exchange the products of their effort.

Subject to such adjustments as may be necessarily dictated by the trend of international politics and events in foreign arenas, this implies the slow, temperate and judicial withdrawal of special privileges and immunities, tariff subsidies, and public subventions; it implies restraints on the relatively unlimited powers of the corporate entity; it implies the treatment of the corporation as a creature of the law, not as the product of "natural selection"; it demands the exercise of responsible public power to prevent the exploitation of human beings.

Thus can the dignity of the individual be preserved; the substance of the democratic process be maintained against the encroachments of irresponsible bureaucrats and personal government vested with vast and unrestrained authority. Thus can there be constructed a line of defense against the type of political organism in which the stakes are so high, the rewards of power so great that they may be expected to corrupt the essence of democratic institutions; and thus may there be secured for future generations the traditional American Society—democratic in its political structure, democratic in its social aspirations, democratic in its promise of opportunity.

REMARKS BY THE CHAIRMAN

MR. THOMAS I. PARKINSON: As I said a moment ago, we have a great opportunity and responsibility in this country to get at the issues and perhaps the solution of some of the problems which face law and government in their relation to business. We have been assured that this great investigating agency which Congress has created means to do a serious, earnest job in getting at the facts and in interpreting them. The facts are elusive, not easy to distinguish, and difficult of interpretation. We will be dependent very largely for an honest pursuit of these facts and a fair hearing to all who have the means of contributing to the factual study, upon the fairness and the courage of the presiding officer of that committee. We are fortunate that he is a man of courage, of experience, and of judicial-mindedness.

The Senator from Wyoming has shown in his contribution to public affairs those characteristics which the chairman of such a body should possess. Among his other accomplishments is the fact that he is the author of that very important and remarkable document, the report of the subcommittee of the Senate Judiciary Committee which condemned the proposal to pack the Supreme Court of the United States. (Applause) It is a very great pleasure and privilege to present to you the Honorable Joseph C. O'Mahoney, United States Senator from Wyoming, and the Chairman of the Temporary National Economic Committee.

INDUSTRIAL ORGANIZATION AND THE AMERICAN IDEAL OF LIVING

THE HONORABLE JOSEPH C. O'MAHONEY
United States Senator from Wyoming
Chairman of the Temporary National Economic Committee

MR. CHAIRMAN, Dr. Douglas, Ladies and Gentlemen of the Academy of Political Science: Just a short while before your distinguished and able Chairman opened this meeting and was followed by Dr. Douglas with his remarkable and searching paper, I was conversing here with Mr. Lamont upon the one hand, and Mr. Parkinson upon the other. A gentleman from Wisconsin came up behind us to speak to Mr. Parkinson. He introduced himself to me—he needed no introduction to Mr. Parkinson—as Mr. Kohler, of Wisconsin (applause), and by way of further identification, he said, "You know, I'm a plumber."

"Well," I said, "you have nothing on me; I'm a plumber's helper." (Laughter) That is the literal truth, because when I was going to Columbia College, part of the University which nurtures this Academy, I worked all one summer as a plumber's helper on the construction of the John Wanamaker Building.

One day after I had entered the practice of law out in Wyoming I mentioned that fact of my early history to a group of friends, one of whom was my lawyer—my partner, I mean, (laughter) in the law business. Well, he was my lawyer, too; I will admit that. (Laughter) But, lawyer or partner, he was somewhat of a wit. After I had boasted of my experience as a plumber's helper he remarked, "Now, that explains something to me. I have always wondered why it is that whenever Joe goes to court, he always has to go back to the office for his books." (Laughter)

Well, after having listened to Dr. Douglas and Mr. Parkinson, I would like to go back to the office for my books tonight before undertaking to discuss this very important subject, I am here because Miss Warner insisted that I should be here. I have just completed three weeks of campaigning out in the Far West, and I reached New York City this afternoon by air from Cheyenne, so you see I am in need of my books. I am in need of my papers. Indeed, I am in need of my thoughts.

But as I begin I feel as though I might have had a compliment if it had not been for the fact that Dr. Douglas brought Mrs. Douglas to the party with him. He was calling me " David ", but she insists that I should be " Daniel ". (Laughter) I want you to understand, however, that although I do not approach this problem with a sling shot. I should prefer to be called " David " tonight. What terrible punishment you folks would be compelled to take if a Daniel and a Senator, at one and the same time, should arise to address you. You all realize, of course, that there is no limit on debate in the Senate (laughter), and that when a Senator takes the floor no crisis under heaven can stop him from talking. (Laughter)

That reminds me of an incident that took place back in 1934 when a certain distinguished member of the Senate was taking full advantage of the rule. On the occasion of which I speak, he had been talking for exactly three weeks. (Laughter) I mean that literally—he had been talking for three weeks. He would come in every day when the session opened, and take his place with books piled upon his desk, copies of the *Congressional Record*, volumes from the Congressional Library, manuscripts, and what not. He was discussing new deals and old deals. He was analyzing the money system, and in order to elucidate the subject he had gone back to the dim recesses of history, and was talking about the Babylonian system.

As he proceeded with the discussion, he used one of those eloquent passages in which we all like to indulge occasionally, and he said, " The past rises before me like a dream." Then the word " dream " suggested to his mind the popular song of the day, and he turned around to the rest of us, smilingly, and said, " Have you ever seen a dream walking? " (Laughter) Whereupon Senator Borah, of Idaho, jumped to his feet and said, " No, Mr. President, but I have heard a dream talking." (Laughter)

I hope that nobody in this audience tonight will leave the room thinking that he has heard a dream talking, though we

must think in terms of dreams occasionally. The subject matter which has been assigned to us tonight seems to evoke in my mind, and I hope it does in yours, some of the dreams of the past.

The subject is, " Industrial Organization and the American Ideal of Living ". Industrial organization is a material fact; the American ideal of living is a spiritual fact, a hope, a dream. If ever there was a time in the history of America and of the world, when men and women should try to evaluate that dream, this is the time.

Whoever selected this subject certainly understood the problem of our times. He realized the close interrelation between industrial organization and the American ideal of living. We hear a thousand voices talking about the destruction of the American ideal, of the undermining of American morale. Some say that industrial organization is responsible, some say that government is responsible. Whatever we may think of it, we must know that if there is any such weakening of American ideals, responsibility must reside somewhere. The task falls upon us to discover just exactly what that responsibility is, how it may be measured, and what should be done to sustain the American ideal.

Industrial organization has changed through the years since the establishment of our country. I do not believe that the American ideal of living has changed. Industrial organization is a means to an end. The American ideal of living is an end in itself. It is an end which was expressed by those who wrote the Declaration of Independence. It is an ideal that was expressed by those who framed the Constitution. It is an ideal which has been expressed by every great political leader that we have ever had, and certainly by every great educator who has taught the generations of Americans.

This ideal of ours is understood by all. It is the ideal that every individual may have the full and free opportunity to develop the talents which an All-wise Providence may have bestowed upon him, and that no earthly power should be permitted to deprive him of that opportunity. (Applause)

I believe that is still the ideal of America. In all of the political debates (let me talk quite frankly) which we hear nowadays, in all of these economic arguments, in all of the philippics delivered from whatever platform, we find, as a central theme, a fundamental belief in democracy. I have come to the conclusion that the great majority of our people—no matter what their profession or calling may be, no matter whether they occupy a high or a low position in the economic scale, no matter whether they are educated or illiterate, rich or poor, men or women, powerful or weak—believe in that fundamental doctrine of freedom for the individual from all forms of arbitrary control. (Applause) It means that America is sound.

This industrial organization of which we speak has changed tremendously within the lives of most people now living. Certainly there is nobody in this large auditorium tonight who does not remember a grandmother or a great grandmother who had a spinning wheel in the corner with which she spun the yarn that went to make the clothing for the family. We have seen industry move from the home and the farm to the factory and the city. Industrial organization has changed within seventy-five years, changed to such a great degree that it has completely altered the face of the globe; not only of the United States but of the entire earth.

Steam and electricity were responsible for taking manufacture out of the home and off the farm and moving it to the big cities. In 1880, less than 18 per cent of the people of the United States lived in cities of 25,000 or more. In 1880, 74 per cent of all our population were denominated by the Census Bureau as rural population. Today, almost 50 per cent of our people live in the big cities, and only 22 per cent of all the persons who are gainfully employed are now called agricultural workers by the Bureau of the Census.

This is an alteration which has been wrought by invention, by the harnessing of forces which have enabled man to extend himself far beyond the geographical boundaries which used to confine our forefathers. It is unnecessary for me to say to this audience that when the Constitution of the United States was drafted, there were fewer than twenty-five corporations in the entire country. Most of them were transportation companies, highway and canal companies. Several of them were financial corporations. Only three were business corporations. The real development of the corporation, as everybody in this room knows, did not begin until long after the Civil War. It came when man began to be able to use the inventions of

his mind. Invention has always changed society. Invention has always made it necessary for us to seek new forms of social organization, but it has never yet changed a spiritual ideal.

Think of the feudal system. What put the feudal system behind the veil of history? It was the invention of gunpowder and the gun. When a man with a gun could stand a hundred yards from a knight in armor, beyond the perimeter of his sword, and put him out of combat, the feudal system had come to an end. It took men one hundred and fifty years, however, to find out that that change had taken place.

In the United States of America today the concentration of population and of industry has gone to such a point that although there are more than three thousand counties in the whole country, 71 per cent of all workers and more than 80 per cent of all persons who draw salaries are living in one hundred and ninety-eight of them.

And so we are no longer a rural and agricultural nation but an urban and industrial one, and our problem is to preserve the American ideal of living under the altered conditions. It becomes clear how difficult it is to do that when one considers the effect of the change upon our people. A hundred years ago, seventy-five years ago, when hard times came, when depression showed its ugly face and men lost their jobs and were unable to sell the proceeds of their work, they were still able to support themselves because they could live upon the land. They had not been divorced from the soil.

We have lived to see the time when almost one half of our people have been so completely divorced from the soil that they cannot support themselves when depression comes. The industrial worker in a big city like New York, living in a rented apartment, or at least in a home upon which he is paying a mortgage, is no longer self-sufficient when he loses his job and his savings have been exhausted. He cannot do what his father or his grandfather did, because he cannot grow potatoes upon the city pavement; he cannot grow chickens upon an apartment roof; he cannot support himself, and industry does not support him.

And so the unemployed of our time become dependent upon something outside of themselves, outside of the industrial organization through which they make their living.

Hand in hand with this transformation of the nature of our population, of course, has been the growth of the great corporation to which Dr. Douglas has referred. Just about a month ago I was talking in this hotel to the New York Board of Trade, and in the course of that talk I referred to the fact that there are thirty giant corporations in the United States, twelve of them banks and eighteen of them industrials, railroads or public utilities, each one of which has assets of more than a billion dollars, while there are twenty-two states, sovereign states of the Federal Union, the total value of the real estate within whose borders is less than a billion dollars each. So I said that many modern corporations had become vast economic states.

A national magazine commenting upon the statement, as if to discount it, referred to another item which I had not mentioned because I had not the time, that the stock ownership of these giant corporations, or the most of them, is widely distributed throughout the population.

That is, of course, an undeniable fact, but its significance is not generally understood. I have here a pamphlet issued by an organization called the Investors of America, Inc., in which there are listed one hundred and ten of these large industrial corporations, which do the business of the United States, and here it is pointed out that of something more than four and a half million stockholders in these one hundred and ten corporations, considerably more than three million own less than one hundred shares each. Indeed, the authors of this pamphlet assert that 86 per cent of all the stock of these one hundred and ten corporations is owned by persons each of whom has a hundred shares or less.

What does that mean to the man who is searching after the truth? What does it mean to the man who is searching for the facts? It means that the modern corporation is exactly what it started out to be, an instrumentality whereby the collective resources of the people could be used for a beneficial purpose. And so these huge corporations are not only economic states, greater in some instances than the political states of the Federal Union, but they are collectivist states, because they are made possible by the collective resources of millions of our people.

It is pointed out in this pamphlet that these small stockholders in these one hundred and ten corporations, about three and a half million of them in number, are more by almost a million than the employees of these same corporations. So here we have the picture that comes to my mind, of great industrial organizations composed of millions of stockholders (stockholders who cannot exercise and do not exercise any power whatsoever over the government of these corporations) who have invested their savings, their small savings, and composed also of millions of workers who likewise do not exercise control over these corporations.

The question which must propound itself, therefore, to every intelligent mind looking for the facts is, Does this represent democracy? What is the answer which society must give to that question?

We know that we have this economic problem, and we know that it arises not only here in America but throughout the world. Think of what has happened politically in the United States during the past generation. I should say that there were two great fears which have dominated the minds of American citizens during that period. The first fear was that expanding corporate enterprise would dominate government. It was in resistance to that dreaded domination of the people's government by so-called Big Business that every single political campaign for the last forty years was shaped. Dr. Douglas referred to the fact that, as long ago as Grover Cleveland's administration, the finger of warning was pointed at this condition. But there is another danger which bulks equally large in the minds of those who desire to maintain the American ideal of living. It is the danger of Big Government. The second great fear, widespread throughout the land, is that both business and the people might be dominated by government.

So here you have the twin evils against which, if we desire to maintain the American ideal of living, we must join forces. We must make certain that no private financial power shall dominate the government of the United States or the government of the states, but we must make equally certain that no political party and no political group shall dominate the government and in turn dominate the lives of the people of America. (Applause) We should not call him a radical who undertakes to issue a warning against the power of accumulated wealth to control the lives of the people, because the history which lies behind the establishment of our government is the history of a people who resisted accumulation.

Have we forgotten that one of the principal achievements of Thomas Jefferson, according to his own estimate, was the abolition in the United States of the rule of primogeniture? It was opposed by business men in England before Jefferson started the campaign against it here. Why? Because the business men of England resented, as an impediment to opportunity, the handing down from father to son without liability for debt of the real property belonging to the family. And then, of course, every student of political economy knows the story of the rule against perpetuities. It is a fundamental concept of the thought which gave birth to the American form of government, that accumulation of wealth and economic power should not be permitted to hamper the opportunity of the masses.

Now, how important that is to us, and particularly to those who are the leaders of business, becomes clear if we just take the time to look across the ocean to see what is going on in Europe. In Russia, in Germany and in Italy, because of these very forces which have been operating here, whereby through the new industrial organization a few men are able to extend their power far beyond the boundaries within which their ancestors acted, government has ceased to be democratic. Indeed, it has ceased to give any hope of democracy in Europe, because men and women, deprived of the opportunity to maintain themselves in the new industrial era, have turned to government saying: "Here, take our liberty, take it and do with it what you will, but give us economic security."

And here in the United States we hear the same cry rising. Who can explain the proposals which come from coast to coast for government pensions, for thirty dollars every Thursday? Who can explain the plans to share the wealth, and all similar devices unless he sees in them the turning to government of people who are unable to maintain their own security, asking government to do it for them?

During fifty years this trend to Big Government has been going on here. Our people have been turning to Washington

and have been creating there larger and more numerous government establishments to rule the economic world because individuals have been unable to cope with it. Is it a thing that we can afford to allow to develop further? Is it not clear to every thinking man that a government establishment of this kind, if it continues to grow, will finally either collapse of its own weight or else will turn into one of those all-powerful governments which are the antithesis of the American ideal of living?

Now, I see a great deal of hope in the situation. I have conferred with business men, with professional men, with educators, with politicians and all the rest in every part of the country, and I see an underlying sentiment among our people to maintain the American ideal of government, to maintain freedom, to maintain freedom in business and in politics. And I have no hesitation whatever in saying here, as I have said in many places, that 90 per cent of even those whom we call big business men all want to preserve the American ideal.

In these three weeks of campaigning which I have recently finished, as I traveled from one state to another in the West and over the roads in my own state, I was impressed with this fact, that whenever you saw an instrumentality of big business, you saw a modern enterprise, a modern convenience; you saw a cleanly place; you saw what was obviously an efficient place. And if you study what has been going on among business establishments, you must come to the conclusion that most business men want to afford economic security to their employees, but the trouble has been that we have been unable to see the way, we have been unable to develop the rule.

I am convinced that our people are anxious and waiting for the opportunity to coöperate in the establishment in America of a clear and definite principle whereby we may preserve at one and the same time the industrial organization which has contributed so much to our comfort on the one hand and also our democratic ideals of living and of government, on the other.

I came here today in an airplane, (applause) and as I was traveling in that plane there came to me the thought of what it meant, of what it was, of what it portends. We had just left Toledo and were on our way to Cleveland, when in the foreground I could see some distant clouds. We were at an altitude of some nine thousand feet. There were white, fleecy, cumulus clouds in the sky ahead, and I wondered what the pilot was going to do, whether he would fly beneath those clouds or through them or above them.

Finally the plane nosed into the middle of the cloud, and we were enveloped in fog. I got up from my seat and walked back to the door where there was a larger window, and looking out I saw the top of the clouds as we emerged above them. There, as far as the eye could see (I am describing to you only what most of you have seen yourselves) were these little hummocks of white clouds almost like islands in a lake. Then I looked down. The sun was shining, and there on the top of one of those huge clouds was the shadow of the plane in which I was riding; the shadow of the plane!

There was I, between the top of the clouds and all eternity in a machine that was built by man; not by one man, not by two, but by generations of men. Somebody had to discover how to dig down into the bowels of the earth to mine metals; somebody had to discover electricity; somebody had to discover oil and learn how to refine it and make gasoline, and somebody had to invent a gasoline engine. I could stand here for half an hour listing the various elements which went into the construction of that plane. It was the achievement of mankind. It was the achievement of free men. I cannot see failure for the race which has done this.

I am convinced that in America, in the United States of 1938, there are the men who are willing and able to preserve all that is good in industrial organization, and at the same time lay a permanent foundation for permanent democracy.

Industrial organization must and shall be made to serve the American ideal of living.

Remarks by the Chairman

Mr. Thomas I. Parkinson: As I suggested in the beginning, the Academy provides this forum for the discussion of the issues of the day. I have been warned to remember that my function tonight is that of a presiding officer, and not to yield to the temptation of the occasion, the audience, or the very provoking and inspiring remarks of the speakers.

I have been warned also to say to you that however much you are irritated or provoked by the speeches to which you have listened, we cannot provide you with an opportunity to express your own point of view tonight. It remains, therefore, for me, on behalf of the trustees of the Academy, to thank the two distinguished speakers who have come here tonight, to express our appreciation of their contributions to our thinking and to our information, and to thank, also, those who have appeared on the program during the day, and to express our appreciation of this great audience who have come under the auspices of the Academy on this occasion.

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THE PRESERVATION OF DEMOCRACY —AMERICA'S PREPAREDNESS

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
MAY 3, 1939

EDITED BY

JOHN A. KROUT

THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY
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PREFACE

ARE we educating our youth to assume the social responsibilities implicit in the democratic tradition? What is the relation of our foreign policy to the preservation of that tradition? In view of the mounting debt and heavy tax burden, can we long continue our program of national preparedness even on its present scale? Is it possible for us, without sacrificing basic democratic processes, to organize our national resources effectively for war? These are some of the perplexing questions which received careful consideration at the Semi-Annual Meeting (Fifty-ninth Year) of the Academy of Political Science on May 3, 1939, at the Hotel Astor in New York City. The answers here presented, however tentative, reveal a wide range of opinion, informed and challenging. Through them all there runs a note of confidence not often heard in current disputations concerning the future of democracy here and abroad. It is an impressive testimony, for it comes from those who are discriminating observers and judicious commentators.

The Academy is grateful to the distinguished men and women whose formal papers and extemporaneous remarks have made possible this volume on "The Preservation of Democracy—America's Preparedness", and to the able Committee on Program and Arrangements whose membership included: W. Randolph Burgess (Chairman), Miss Ethel Warner (Director), Grenville Clark, Frederic R. Coudert, Lewis W. Douglas, Allen W. Dulles, Leon Fraser, Pierre Jay, Thomas W. Lamont, Sam A. Lewisohn, Roswell C. McCrea, Wesley C. Mitchell, Shepard Morgan, Francis T. P. Plimpton, William L. Ransom, Gordon S. Rentschler, Beardsley Ruml, Eustace Seligman, Myron C. Taylor, Eliot Wadsworth, John H. Williams, Leo Wolman, Thomas F. Woodlock, Owen D. Young.

CONTENTS

PART I

PREPAREDNESS AND FOREIGN POLICY

INTRODUCTION *

FREDERIC R. COUDERT, *Presiding*
Trustee of Columbia University

WHEN I came here I asked Miss Warner, who for so long has graciously and efficiently managed these meetings, what I was to do, and she replied: " Please speak for about five minutes about preparedness." Whether that is a license or a limitation, I am not sure; I shall treat it elastically.

The purpose of this meeting is to discuss (and we have some very able people to discuss it) the relationship between democracy—a word that I hate because it is so vague and largely meaningless, but democracy as used in the conventional sense in our own country—and preparedness for the eventualities of a struggle in which the life of that system may be involved.

I remember, because unfortunately my memory goes back quite a long time, the great campaign for preparedness in 1917. We had a committee from the National Security League which traveled over much of this country, from New York to Topeka, Kansas. The original members of the committee were Mr. Henry L. Stimson and myself. It was a very interesting experience because a great many of the people to whom we spoke, several times a day at meetings, had never heard the term " universal military service " before; it was a new one to them.

I well remember one typical meeting because I thought it was so purely and so finely American. We had arrived at Topeka, Kansas, after a long and hard day, and after four or five addresses en route on the same subject. We arrived at Topeka about six in the afternoon, and our hope was to get to the hotel, to have a bath and then a quiet dinner, and after that to orate on the subject of universal military service.

* Opening remarks at the First Session of the Semi-Annual Meeting.

We were met by a delegation of very sober, serious-looking people, who said to us, " We have been waiting for you at the hotel; the audience is ready to listen to you now!" I protested mildly and said, " We need a bath and we need some dinner."

" Oh," they said, " you are good enough as you are. The folks is waiting at the hotel to see what you people have got to say about this universal military service thing."

So we went to the hotel, where we found everybody waiting; they received us in silence. Many of the women were knitting. I think the whole town was out, hundreds of them. We sat down at the table, ate a very simple meal, and in a very short time we began.

I made a brief address on the necessity for military service in view of the then impending events (we were only a month away from the war), and then Mr. Stimson began to speak. A door opened behind me and three of the largest, most brawny, powerful, heavy-jawed individuals that I have ever seen stood behind me. One of them tapped me on the shoulder and said, " We would like to have a private word with you, sir."

Well, I thought, here comes my fate. Whether it is to be the gallows or some other form of execution, I do not know, but I must have said something that is not popular in the state of Kansas.

I walked out, putting on as brave a front as I could, and they said, " We have got a question to ask you. The folks in there is open-minded on this proposition, and we do not know what they are going to decide when you men get through talking, but we want to know one thing about your military service—we want to know if the poor man's son goes to war just the same as the rich man's son, and under the same conditions. We must know that, and when you three men have answered that [because Mr. Wolcott, later Senator Wolcott, had joined us], we will then give you a reply."

" Oh," I said, " that is perfectly easy. Universal military service is the inevitable concomitant [I didn't use that polysyllabic word, but I paraphrased it] of the democratic system that we have. If a man has the right and a woman has the right to vote, they both have the duty to the utmost of their capacity, and all equally, to serve the nation." That was the

reply we made, and curiously enough we received a ninety per cent vote from that silent, attentive audience.

I thought it was typical of America: this willingness to listen and to do one's duty under proper conditions. Within a very short time, there was actual general military service in our land.

I do not believe that this spirit has changed in any way. Some years ago, in 1936, I had to write to a very dear and honored friend of mine, who has since died, Sir Austen Chamberlain, brother of the present Prime Minister, and I concluded my letter with a rather banal remark, " that we were living in an interesting age."

Evidently he read the whole letter, because by return mail he wrote to me and concluded as follows: " Many years ago, I learned from one of our diplomats in China that one of the principal Chinese curses heaped upon an enemy is, ' May you live in an interesting age.' " " Surely ", he said, " no age has been more fraught with insecurity than our own present time." That was three years ago. Shortly afterwards, he went on to another, and, I hope, a higher and better sphere than that in which his brother was left to carry on. Sometimes I think, if he could see the augmented insecurity in which we now live, he might be glad that he had not had to face our time.

After all, we are today at the crossroads. Our great Fair shows that if science, modern science—the thing that marks us out from other ages and times—were applied to the betterment of humanity, we could live in something like an Elysium. But we can not help wondering whether modern science will be organized and focused so completely to destroy our civilization that in the ages to come we shall be classed with the Sumerians and with those remnants of old civilizations along the Euphrates and the Nile.

That is apparently the question that is confronting the world —what is the goal of civilization? What are the things that are worth striving and fighting for?

I take it that for most of us they are simple enough. One of them is a government in which minorities have rights—the right to free speech, the right to order their lives in their own way—in other words, that the touchstone of civilization is that the individual himself is worth something and is not to be ordered about or to be carried about at the behest of some group or of some one man.

No American can look at the original Magna Carta at the World's Fair without emotion.

If that is the touchstone of civilization, then with all our defects, with all our self-criticisms, with all the troubles we have, we and a few other nations—English-speaking and French and Swiss and Dutch and Scandinavian—have something that is worth keeping. If it is worth keeping at all, it is better than peace, because people perish by peace just as they do by war. Rome perished because it loved peace more than justice—or its population did—and because it hired other peoples to fight for it who in the end themselves overcame Rome, just as on the other hand Greece perished because its people had so many wars among themselves.

Peace is the second best thing in the world. The best thing in the world is justice; and that is the thing that democracy must always be ready to maintain at all costs, if it is, as we believe, a system worth maintaining.

If the audience please, we are going to have an address by someone who is known to everybody in this country—a family friend of the evening and of the daytime. I know that in my own home when I hazard any remarks about foreign affairs, which I occasionally do in modest and self-effacing fashion, my wife says to me, "I am not sure whether you are quite right, because I do not think Mr. Swing feels that way."

When I am told that, I am always ready to revise my opinion, and I am sure that you feel likewise, and that you will listen with great interest and pleasure to a man whose knowledge and clarity of thought and precision of language always delight. Mr. Raymond Gram Swing!

OUR FOREIGN POLICY IN EUROPE

RAYMOND GRAM SWING
Radio Commentator on Foreign Affairs

MY attention has been called to a quotation from Thomas Hobbes dating from 1651 on the subject of war weather. It reads: "War consisteth not in battle only, but in a tract of time wherein the will to contend by battle is sufficiently known. . . . For as the nature of foul weather lieth not in a shower of rain, but in an inclination thereto of many days together; so the nature of war consisteth not in actual fighting, but in the known dispositions thereto during all the time there is no assurance to the contrary." American foreign policy in Europe is a policy designed for what Thomas Hobbes calls war. A conflict is going on there, it is at an advanced stage, and we are in it. But let me expressly disavow saying that we are bound to be involved in combat warfare if it comes. I only say that a conflict already is in an advanced stage, in which we are taking part.

There are, I suggest, three stages of partisanship in international conflict. They are: the stage of diplomatic protest, the stage of using economic weapons, and the stage of combat warfare. Fortunately not all the stages have to be experienced in every conflict. But let me say this; if the stage of using economic weapons is reached, it still is the same conflict which began with diplomatic protests. And if the use of economic weapons is not victorious and combat warfare follows, it still is the same conflict. The name of that conflict is not war, as many people use the word, but Thomas Hobbes called it that, and I urge his usage as more than correct; it is wise.

In that sense, let me say before going further, the use of economic weapons *is* an act of war. And they should not be used excepting in a conflict which is worth winning. But I deny the quite arbitrary assertion that seems to be part of current American thought today, that the use of economic weapons *must* lead to war, meaning to combat warfare. There is no human experience to give that assertion the validity of a law. As a matter of fact, we are using an economic weapon against Germany at this moment, and its use has not brought us into war with Germany. For other reasons we may find ourselves in combat warfare with Germany, but the penalty tariffs applied to German imports will not have made that combat warfare inevitable. We are using economic weapons in the Chinese war, in buying Chinese silver and in making a loan to the Chinese government, both of which are stabilizing Chinese currency, and are affecting the conflict in Asia more palpably than would many of the recognized weapons of combat warfare. And yet the use of these weapons has not led to combat warfare, and there is not the slightest certainty that it will. It is arrogant ignorance to say that the use of economic weapons *must* lead to war, since the statement is not an observation of experience. And it is also a want of understanding that defines peace as any condition devoid of combat warfare. This is a comfortable ignorance and a dangerous one. For it makes the mere avoidance of combat warfare seem to be the avoidance of war itself, and it may lead to the losing of war. In this way Nazi Germany was able to win a crucial battle at Munich, and again in the annexation of Bohemia and Moravia in March of this year. Great Britain and France last October did avoid combat warfare, but they came near to losing a war. And today Great Britain and France, by trying to build a chain against aggression, are trying to redeem defeat without combat warfare, trying to win what they forfeited last October, at a far greater price than they were willing to pay at that time.

American policy in Europe cannot be understood without understanding the nature of the conflict in Europe. Here one must avoid glib, current descriptive phrases. The conflict is not primarily ideological. It is nothing so simple as a fight between democracy and totalitarianism. It is this only in a secondary sense, or one might say the ideologies of Europe are over-tones of the primary tone. The conflict is first of all one for power. One group of Powers is contending with another group for three objectives: the supremacy in the possession of combat weapons, the control of strategic points from which these weapons can be used, and the mastery of the regions producing the materials essential to the prosecution of combat war. Now, a naked power conflict is not an edifying spectacle. But

it is a reality whose development and outcome affect nearly every country and person in the world. It so happens that one of these two groups of Powers, Britain and France, had supremacy over the other group, Germany and Italy, for some time in all three of the categories I have named. In that time of British and French mastery the United States has managed to be independent, and to go about its affairs with little interference. The other group does not offer so much independence to the United States if it wins the conflict. It is a group which does not believe in international coöperation, in the virtue of treaty obligations, in the maintenance of peace as a desirable philosophical concept, and which is committed to a policy of expansion, justified on grounds of racialism and nationalism, both ideas endowed with a mystical dimension. The empires they intend to rule are not to be held in trusteeship. The individuals they wish to rule will not be guaranteed their liberty. In this conflict, the victory of the group with which the United States has found its national life to be free and unmenaced appears preferable to the United States to the victory of the group whose international morals are on the baser level. That provides the first motive for the participation of the United States in the European conflict. The United States is interested in the conflict, its future will be affected by its outcome, so it is, in its own way, according to its own principles, influencing the conflict for its own sake, in its own interest. The nature of this influence, as well as its motive, has not, I believe, been sufficiently understood or sympathetically interpreted in this country. The evidence about international affairs has by no means been fully presented before the court of public opinion. The general public knows little more than it reads in the newspapers, or hears on the radio. Students of international affairs do hear a little more, though it is only a little. But this little justifies a statement which needs to be made with authority as soon as that becomes practicable and which I make with no authority at all, though I say it with all personal conviction. It is that the United States is largely responsible for the change of British and French policy since Munich. By the United States I do not mean Franklin D. Roosevelt alone. I do not mean the State Department. I mean the United States as a whole, a sensitive and responding public opinion first of all, and thereafter the actions and influences of the President and the officers of the State Department. I do not mean that the influence of this country would have been enough to lead the British and French to abandon the appeasement surrenders without the strong influences at work in British and French public life. But I do believe that without the influence of the United States the change might not have been made. It is as crucial as that. The first influence was that of Americans as a whole. They knew more about the crisis of last September than any other people, because of their better news services and above all because of the phenomenal coverage of the crisis by the radio. The crisis was an intimate experience of a large number of Americans, which they shared more vividly than many of the people who were in much closer danger. The judgment of the United States on the settlement of Munich was for this reason more quickly formed. This is a new factor in international relations. The distance of the United States from Europe has been reduced to a point beyond the imagination of a century or even a generation ago. This presents a task to United States diplomacy beyond the scope of earlier years.

The judgment became quickly established in this country, particularly in government circles in Washington, that the settlement of Munich had been an acknowledgment of weakness, and not a valid act of appeasement. This view naturally could be frankly adopted here, where there was no responsibility for the nature and results of the Munich conference. Since weakness called for an effort to rally strength, the influence of the United States, through its official contacts, was on the side of a reversal of the Munich attitude. The first departure of the Administration from the mere expression of moral opinion to the more drastic stage of diplomatic action came in the withdrawal of Ambassador Wilson from Berlin in protest against the governmental persecution of Jews in Germany. It is not sufficiently appreciated in this country how the news of this action by the United States, till that time an aloof and lukewarm country, electrified people in Europe, especially in Great Britain, where people had grown to a sense of helplessness against the almost morbid tolerance practiced by the Chamberlain and Daladier governments. And when the time drew near for the next Hitler stroke, early this year, the sale

of American planes to Britain and France introduced a factor of reality to the power conflict. The inferiority of British and French strength in the air was not reduced at once, but potentially it was seen to be reduceable to the point that would make another Munich unnecessary and inexcusable. The morale of British and French public opinion rose, and infected the British and French governments. They perfected their military alliance, they agreed to defend Holland and Switzerland. Early in the year the stroke which might have fallen in the West was averted. Then came the days of March, when Hitler for the first time departed from his own thesis of racialism and self-determination, and launched on a new course of expansion of empire in breaking up Czechoslovakia, and annexing Bohemia and Moravia. This not only was denounced first of all by the United States government, before the Western Powers had caught their breath, it was followed by the application of penalty tariffs to German imports. We had entered the conflict on a new level, we had laid hands on an economic weapon.

In breaking the settlement of Munich, Hitler demobilized some of the most useful allies he possessed, the conscience-stricken and right-minded people of Britain and France who had defended his earlier acts of treaty breaking because the treaty had been their sin, and it had violated the moral rights of Germans. But when Hitler incorporated the Czech people into the German empire he was through with the moral stage of Germany's restoration. He shook himself free from his allies in Britain and France, and left them behind. The march of sheer conquest had begun. Then it was that Chamberlain and Daladier, the makers of Munich, could themselves repudiate Munich-ism. They could turn about face with breath-taking earnestness and begin on the forging of the chain against aggression.

The interest of the United States in the conflict, the sympathy of the people of this country, and the official inspiration of the President and the State Department were not the cause of the change. But they were, I believe, a precondition to it. And I am confident that when the archives of the White House, the State Department, and the British and French foreign offices are at last open, they will show that the course of the Western Powers could hardly have been set in the direction it has taken without the part played by the United States.

The policy now being pursued has been called one of war-mongering. It also has been blessed as peace-mongering. In my opinion neither name is correct. There is no certainty that the policy will lead to war. There is, alas, no certainty that it will bring peace. The only certainties are, I suggest, these two: That without the reversal of the surrender kind of appeasement as practiced at Munich, the supremacy in power would have soon passed to the totalitarian states, to be wielded by them according to their repugnance to international morality, and to the danger of all liberty of sovereign nations and individuals. The other certainty is that if there is to be peace it can only come by strong nations making peace in the freedom of their strength. Stopping Hitler, of course, is not in itself peace. Hitler is the final expression of the absence of the conditions which by their nature permit peace. Peace can be made once Hitler is stopped. And in that peace the United States must play a part as it has played a part in stopping Hitler, if he is going to permit himself to be stopped. The President's peace message was a partial recognition of this responsibility. It will bear repeating, over and over again. If there is to be peace, the German people must hear it, they must know that peace is going to be possible, genuine and generous, that the statesmanship of the Western Powers is ready at last, at long last, one might say, to face the responsibilities of peace. There need be no confusion between the two functions, the one of stopping Hitler, that is, of stopping wanton aggression and immoral conquest, and the other of making a real peace. The one is the precondition to the other. Unless the stop-Hitler movement is dominated by the will to peace, it has no place in civilized thought. And the corollary of that statement is equally true. Peace can only endure in a world of law and international honor, and unless the love of it is conditioned by the determination to end gangsterism it too has no place in civilized thought. War in Europe is not inevitable. It has to be created by human folly. But neither is peace inevitable. It has to be created by human wisdom. Peace is not just staying out of war. It is not a negative policy. Peace is the creation of a safe world. And it is most of all in that act of creation that the spirit and vitality of the United States are needed.

Remarks by the Chairman

Chairman Coudert: You see, I was a very good prophet. You could hardly conceive of a clearer or more dispassionate analysis on the terribly difficult and complex situation of today.

I could not help thinking, when Mr. Swing was speaking of the fact that we in America have been able to live in a reasonably safe world while the far-flung British Empire is in its present state, that one of my earliest recollections is of a controversy with Great Britain. We so quickly forget history, but, after all, it was not so very long ago, as the life of a nation goes, that American armed vessels were seizing ships carrying the British flag in the North Pacific Ocean and in the Bering Sea, and that the United States was claiming all of the Bering Sea and threatening to expel therefrom all British vessels that intended to take seals. High was the feeling. And then what happened? It comes to me vividly, because as a young law student I went to Paris with my father at the time of the arbitration of the Bering Sea case, and there for three months we heard the dulcet voices of the lawyers alternating with their crocodile tears; and the seals were saved and everybody's rights were adjusted, and the ladies had their sealskin coats. Today, everybody, except a few people who were close to the matter, has forgotten that it ever took place.

I remember another tragic day when crowds formed, looking at bulletins in Wall Street — "War Imminent Pending Ultimatum of President Cleveland". At lunch time that day in the old Lawyers Club, the members were worried and agitated, and my father opened a telegram that was brought to him from the President of the United States telling him to come to Washington because he had been appointed on a commission to take up the matter of the disputed Venezuelan boundary. The lawyers got to work—I realize their defects, but their tears are perhaps better than those of the women and children in war time—and after the Venezuelan-Guiana boundary dispute was settled, nobody remembered how or why or when or what it was all about. It was all very pleasantly arranged after a few months of debate; and so it has been for 125 years. We do not want to see that situation disturbed, because otherwise our vital interests would be necessarily affected.

Ten years ago I had a talk at Geneva with Count Bernstorff. He and I had been in opposite camps during the War, and during the neutrality period for that matter. He said to me, "You know, Mr. Coudert, there is one thing we can agree upon—the fate of the War was fought out from 1914 to 1917 in Washington. I insisted with my government that they would drag America into the War if they persisted in their submarine policy, and they continually answered me by communications as follows: 'America will not fight because it is a hybrid nation without morale. Besides, it cannot fight because it has no army and none of the necessary organization.' I was right on both points, in denying both of those things and telling them that America would and could fight, but I could not get my people to believe me."

"Whom the Gods would destroy, they first make mad." The same things are being said today, after the experience of 1918. It is incredible that it should be so, and that the human mind should be so unwilling to accept the teachings of history, but such is the fact.

Nothing is more important in connection with our foreign policy, of course, than our relations with South America. The Monroe Doctrine and our relation to South America mean that if our policy is wise, if it is neighborly, if it is brotherly, at least there may be a whole great continent from the North Pole to the South Pole where there can be a reign of law and decency.

Among those who have worked valiantly and intelligently and brilliantly to that end is a young Columbia professor, experienced far beyond his years, one of the most brilliant men that we have in the University now and for some years past, and at present Assistant Secretary of State. He will address us on the situation in South America, with which he has had much to do—Professor Adolph A. Berle, Jr.!

OUR FOREIGN POLICY IN LATIN AMERICA

ADOLPH A. BERLE, JR.
Assistant Secretary of State
Associate Professor of Law, Columbia University

THE policy of the United States in Latin America, properly analyzed, emerges as something more than a mere study in international relations. The Western world today is substantially united in a method of conducting its relations. This method stands out in direct contrast to patterns existing elsewhere in the world. It presents the conception of a coöperative peace. It is diametrically opposed to the historic Old World conception of the *Pax Romana,* peace by universal empire.

This concept of a coöperative peace is far greater than a mere Latin American policy of the United States. It is, in effect, a New World policy; a policy which gives leave to hope that a non-military civilization may yet be possible.

I

The chief and continuous premise of the United States in foreign affairs is the independence of the New World from the Old. Other national interests may shift and change; but our policy with regard to Latin America has been constant since the fall of the Spanish Empire. In its earliest form this policy was embodied in the Monroe Doctrine; in most recent form it appears in the Declaration of Lima providing, in substance, for coördinated action to defend the integrity of all American nations and of their institutions. Within the past few days, President Roosevelt again restated that policy in celebration of Pan American Day, pointing out that were the independence of any part of the Americas threatened by force the United States would have to match that aggression with force of its own. Were the threat in terms of economics, we should have to make available resources so that no Latin American country need sacrifice any part of its independence to maintain its economic life.

Stated in simplest terms, this means that the hemispheric line must never be crossed by any non-American Power. The historic vestiges of European establishments here, such as the holdings of the British, the French and the Dutch in Guiana and in the West Indies, of course remain unchanged; and there is no thought of changing them. Occasional proposals to purchase these possessions, such as, for instance, the personal suggestion of Senator Lundeen that we buy the Dutch West Indies, have found little, if any, support in the United States, which today regards these minor colonies as friendly outposts. This government not only has no desire to seek their acquisition; but has stated its intent not to seek a single additional foot of territory. Independence, not expansion, is the American objective.

This policy of hemispheric independence, so firmly embedded in American thinking, is not often analyzed by public opinion in the United States. It is, therefore, apposite to consider for a moment why we have, so continuously, championed it. There is, as usual, something more than mere sentiment behind international policies which persist for many years.

In the very dawn of our national history, American statesmen were men who had had direct experience with constant attempts to create spheres of influence in the United States. They had seen the French Empire grinding against the British colonies along what is today the Canadian border; they had seen a similar process going on in the undefined boundary between Louisiana and our western settlements. Spanish intrigue in Florida and the lower Mississippi had been continuous. Even after the establishment of a new American Republic, politicians who found themselves in difficulties occasionally attempted to recoup their fallen fortunes by lending themselves to these border schemes. Aaron Burr probably had some such misty idea in mind after his duel with Alexander Hamilton had forced him out of public life; General Wilkinson, one of the earliest commanders of the American army after the Revolution, was uncomfortably familiar with, if not actually involved in, similar schemes. Alexander Hamilton, arguing for the adoption of the Constitution, made the point that one of the tasks of a strong central government must be to put itself in a position where the use of border intrigues and political

factions within neighboring colonies could not threaten the independence of the new and growing country.

As the country grew, as Latin America developed, as communications shortened distances, like considerations applied in more distant areas. But the issues changed somewhat. No longer were we afraid that our own independence might be submerged by the action of the then Great Powers. We were, however, concerned lest the New World again become merely a replica of the Old World, whose peace (when there was peace) hung on the balance of military strength. The Great Powers during the nineteenth century were avowedly imperialist; were the New World in any degree partitioned among them as Africa was, our only possible course would have been to erect a counter-imperialism, backed by continuous militarization of our national life.

Thus the modern issue emerges. Today it is paramount. We seek to avoid having the New World drawn into that pattern of life which has cursed the Old: the deadly process of opposing military establishment to military establishment, of living from incident to incident, through minor crises and major crises, forcing our own and our neighbor countries into the path of continual militarism with war always within the nearer horizon. Should the great European Powers find substantial foothold in the West, we should be back, not in the nineteenth century, but in the eighteenth. And in that century every war in Europe was reflected by similar wars here, as the French and Indian wars which reflected the Anglo-French wars of the continent. The fortunes of the War of 1812 gave us breathing space, particularly in view of the weakened condition of Spain; and, with the fall of the Spanish Empire, we found ourselves liberated at last from immediate involvement in European affairs. Naturally the United States, in common with all Latin American nations, has no desire to go back over that long and bloody trail.

This may be called the Latin American policy of the United States; but it might better be called the foreign policy of the American States in conjunction with the United States, for the interests of all of us are the same. In earlier years it was dictated by straight need for self-preservation, and the maintenance of the independence of the nations of the Western world. In later years it has resulted from the desire to maintain for the New World a new, and peaceful, pattern of life.

II

The Americas may fairly claim, I think, in developing this policy to have evolved a new principle in modern history. Elsewhere, Great Powers had apparently been able to build only in terms of empire. The method of maintaining a great area in independence and peace adopted by the European Powers was conquest—an idea inherited from Rome, which could conceive no peace save by conquest of the world, and imposition of the *Pax Romana*.

In place of this there emerged an idea which can fairly be credited to the Spanish liberator, Simon Bolívar. This was the idea of the " community of nations ", a coöperative group of independent countries united in a single foreign policy so far as the rest of the world was concerned. Their methods of maintaining peace among themselves must be highly developed; their understanding must be as complete as communication could make it; and, most of all, they must stick together. This was to be the substitute for the pattern of an " imperial peace ": the *Pax Hispanica* which Bolívar had done so much to overthrow. The idea appealed to the American statesmen of his time: to President Monroe when he enunciated the Doctrine which bears his name; to John Quincy Adams when he joined in approving and sent delegates to the first Pan American conference; to Henry Clay as Secretary of State, and in later history, to James G. Blaine, to Secretary Hughes, to President Franklin Roosevelt, and to Cordell Hull.

It is worth while to emphasize the fact of the new pattern. Even today the United States, which has benefited so much from it, is too little familiar with the strength of the conception, and with its unusual success in the troubled waters of international relationships. A group of nations confederated in the objective of maintaining the independence alike of each other and of the total group: a group of nations maintaining their complete sovereignty as between themselves, yet reaching a point of understanding which permitted all of the inevitable disputes to be settled by peaceful means; an area of half the world capable of maintaining a unity based on understanding;

a group to whom force was needed only to repel aggression from without—this seemingly impossible ideal of a Spanish American revolutionary has at length become a reality. As a parenthesis, I take especial pleasure in remembering that when Bolívar's hopes were at their lowest ebb, he was supported by the Negro republic of Haiti.

It is customary in considering the development of this ideal to point out the many mistakes and lapses from it which have occurred during the 120 years of its practice. Particularly, criticism is leveled at the United States. Lapses there have surely been; but I do not think that most of the charges can fairly be regarded as valid today.

Many of our own major mistakes, indeed, in this hemisphere have been due more to the fear of European domination than to any desire to increase the area of our territory. Conspicuous among these were the interventions beginning at the time of the Panama Canal incident, the Nicaraguan occupation, and the occupations of Haiti and Santo Domingo. It has been customary, particularly among students who hold the Marxist view of history, to ascribe these to desire to protect American capital, which thus became the forerunner of imperialism. Yet as the history becomes increasingly clear, and as the documents are more completely available, the Marxian student finds that the facts do not bear him out. In many cases the intervention of American capital in Central America and in the West Indian Republics was undertaken, not at the instance of American capitalists seeking outlet for their funds. It was undertaken at the direct instance of the American government; and the motive appears to have been the fear lest European capital, affected with European politics, might find foothold on this side of the Atlantic. An example may be found in the occupations of Haiti and Santo Domingo. In each case American banks had purchased the control of the banks previously serving those island countries; but the documents today make it clear that the American financiers did so rather unwillingly, at the direct urging of the State Department; and that the State Department urged the American financial moves as a means of eliminating European financial moves. It may also be noted that alone among the Great Powers of the world, having accomplished that objective, public sentiment in the United States swiftly mobilized against the continuance of the occupations; they were withdrawn freely and without reserve, largely in consequence, first, of the continuous urging of the present Under Secretary, Mr. Sumner Welles, then a staff member of the State Department, and finally, as a part of the broad policy laid out and executed by Secretary Hull. The final result has been the firmer establishment of independent nations who owe their safety not to their military force, but to the strength of the Pan American idea.

III

In the last two years the American relations have definitely and distinctly entered a new phase. The century from the time of President Monroe up to the date of the conference of Montevideo in 1933 was largely concerned with working out the relations of American nations to each other. The conception of Simon Bolívar had to be implemented. We had here all of the natural difficulties which nations have elsewhere; the work, therefore, of constructing machinery for peace, of settling international disputes, of establishing the doctrine that the weakest nation in terms of area and population nevertheless could meet the strongest in terms of juridical quality—all this took time. The unity of the Americas on this basis of common ideal attained substantial unanimity of opinion when Secretary Hull at Montevideo six years ago announced the full agreement of the United States to the doctrine of equality of nations and renounced any right of intervention. This led directly to the adoption of the principles of inter-American solidarity at the Buenos Aires Conference of 1936.

The state of the world thereupon brought the second phase of hemispheric relations to the fore. Up to 1936 we had been dealing primarily with each other. Now it became necessary to consider the relations of the entire hemisphere to the rest of the world. These fall roughly into two categories, political and economic.

Politically, the New World has been once more attacked from the side of the Old, though the attack has not been fully developed, and let us hope never will be. To realize this you would have to follow the course of some of the European propaganda principally released for home consumption in their own

countries. I here merely note a few spectacular points. Certain of the German state-controlled newspapers and commentators have asserted that the great white races must plan the economic disposition of the world; that their heritage is endangered particularly because the Latin American countries do not sufficiently develop their resources. One such piece of propaganda referred particularly to the need of controlling the resources of a considerable part of Brazil. This is the theory of " Lebensraum " with a vengeance. Others have asserted that the Spanish American parts of South America plainly should be grouped with Spanish cultural forces; the Spanish fascist organization known as the Phalanx proposes to organize and is organizing groups in South America today with that in mind. Another attack is the attempt to mobilize for permanent economic and political use the settlements of European nationals who have played a considerable part in the development of Latin America. Still other attempts from the communist side have included an effort to create popular movements dominated by men of communistic faith, with the aim of ultimate capture of local governments.

In passing it should be noted that the communist propaganda and the axis propaganda are not wholly unknown within the United States. The object in both cases is to disrupt relations between the United States and its Latin American neighbors. For instance you will find communists vigorously insisting that many Latin American governments are " fascist " or " totalitarian ". Commonly you will discover that the adjective " fascist " is applied by left groups to any South or Central American government which has not been hospitable to movements of communist flavor; and one object of that propaganda is to attempt to stir up sentiment here against these governments based on the premise (which frequently is wholly false) that they are sympathetic to the axis powers. Too often the real objective of such propaganda is not to serve the cause of " democracy ", as it is frequently and incorrectly termed, but to weaken existing governments by getting them into disputes with the United States for strictly local political purposes. In like manner, you will not infrequently run into propaganda here designed to convince the United States that some Latin American government is " communist "—again a line of argument which is commonly worked up for the purpose of serving some local interest. The actual fact is that, so far as I can see, neither the communist nor the fascist propaganda has made a great deal of headway in South America; the dangers of one or the other are too often magnified in the United States for purposes which are by no means set forth on the surface.

We need not, therefore, take these propaganda attacks too seriously; they have not had great success, and there is no particular occasion to be unduly frightened about them. For our purposes it is enough to know that these movements do exist; and that they do represent a very real attempt, first, to break up the unity of the Americas, and second, to make possible the re-opening of this hemisphere to the modern form of imperialism, which is little more than a new form of the nineteenth-century imperialism whose attacks on the continent were successfully resisted as Pan Americanism became an active and powerful force. It is one thing to realize that these various efforts do not promise great success; it is another to disregard their existence. Further, we as a government have to recognize that all movements whether from communist sources or from the axis Powers have an element in common: they are all directed against the United States, which is rightly regarded as one of the bulwarks of the solidarity of the Americas.

Resentment against this kind of attack has been evident throughout the entire New World. The United States feels it as a matter of course, because it has taken such an obviously anti-American form. But the South American states are equally alive to it. For that reason, there was at Lima a few months ago a clear-cut movement to establish a common front against extra-American forces of whatever sort. The proposals to do this varied in form: Colombia, for instance, desired a frank hemispheric league of nations; Brazil, a collective security pact; the Argentine, always somewhat isolationist, a mere statement of coöperation to preserve peace and independence; the United States, a strong declaration which might be implemented through the process of consultation as circumstances should suggest. Bringing all the various views into harmony, the result was the now famous Declaration of Lima, a forthright statement by the nations of the New World that they would collectively act to repel any attack from outside,

whether that attack took the form of old-fashioned military action, or new-fashioned attempts to dominate the internal structure of a state. From here out the problems of the hemisphere become, in a great sense, those of collective foreign action. It is interesting to note, for example, that every Latin American government moved at once to support President Roosevelt's recent peace suggestion; and the reaction was sufficiently strong so that the move might fairly be called a suggestion by the combined New World toward finding a method of peace in the Old.

This poses the problem. Can the idea of a community of nations which is the peaceful pattern of the New World cope successfully with the idea of the *Pax Romana,* the world imperialism from the Old? History will record the answer; but we may make certain tentative observations even now.

The American community of nations is already mature. It is, in fact, the oldest international group now existing in the world. The Great Powers within it appear to have learned the lesson of self-restraint; and it is beginning to be clear that the advantages of coöperative equality are greater than those of conquest. In sordid fact, it is more advantageous to live at peace, to coöperate in international relations, and to open trade channels, than it is to conquer, to seize territory, and to govern an unwilling population. It so happens—and I am glad of it—that the method of our American relations was not worked out on a basis of sordid self-interest; but we have learned that self-interest is served by the processes of ordinary morality.

It is undeniably true that for a time any nation within the group may take advantage of the coöperation which we know here as the good neighbor policy; and it is probably true that if this were done persistently, the time might arrive when there would be a revulsion against the good neighbor policy in the United States. The genus demagogue is naturally known in Latin America as he is known here; and from time to time he achieves a transient political success. Yet over the years and particularly with increasing maturity, the forces of common sense and reason do prevail; and with patience and good will on both sides we may fairly hope, and experience fairly indicates, that peace by coöperation is infinitely more stable than relationships attained by conquest, or existing through the uneasy operation of military balance.

This is a brief outline of the slow but continuous building of a strictly modern order. It is the history of a true contrast in ideas. Ancient Europe knew the *Pax Romana* as the ultimate objective in world civilization. Every European nation has indulged that dream at one time or another: the Holy Roman Empire included it, the Hapsburgs reached for it, the Spaniards attempted it, Napoleon's brief constellation was cast in that mold. Those dreams are not dead even today.

To the idea of universal empire, the New World is trying, in a magnificent laboratory, the magnificent experiment: the experiment of a coöperative hemisphere. On the success of that experiment hangs, in large degree, the hope of civilization in the modern world.

Remarks by the Chairman

Chairman Coudert: Surely, we all have to thank Professor Berle for a very remarkable paper on a subject upon which very few, if any, of us are educated, and upon which we all need education. I have never heard so good a presentation of the whole question of Pan Americanism and its relation to international affairs.

Our system, whether we call it democracy or representative government—that system under which we live and in which the Bill of Rights bulks so large as a foundation stone—requires education, if it is to be preserved.

We are fortunate in having here the president of one of our fine, respected historic American universities, and therefore I am calling upon Dr. Henry M. Wriston, of Brown University, to address us on "Education for the Defense of Democracy".

EDUCATION FOR THE DEFENSE OF DEMOCRACY

HENRY M. WRISTON
President, Brown University

It seems ungracious to quarrel with a title, but I do not believe that democracy can be defended, unless one adopts the military aphorism that the best defense is a strong offense. That is not a substitution of terms, merely; it runs far beyond and becomes a substitution of ideas, and, in this instance, an absolutely vital substitution. Democracy is a positive idea, not a negative one. Representing as it does, and as by its very nature it must, an ideal rather than a status, any description of its current condition is always disheartening. Any time that you employ anyone to make a survey of democracy the results are gloomy! Its practices are never in accord with its professions, for as practices improve, the ideal leaps yet further ahead. Its eyes must always be fixed forward toward the goal. If they are turned introspectively and self-consciously inward, the result is morbidity. Any idea, such as defense, which implies a fixed position, a static program, an immutable boundary, is therefore wholly inapplicable to democracy. Attempts to defend democracy, consequently, are certain to fail.

No one who looks abroad in the world can fail to observe that faith in democracy has ebbed in the last twenty years. From the days of the slogan, "a world safe for democracy", and the first Russian revolution, which Woodrow Wilson called a "great and heartening" event, there has been not merely a marked recession in confidence in democracy as the best solvent for the world's problems; there are even manifest doubts of its survival. One of the reasons for this change has been the attempt to defend democracy. The totalitarians say it is not efficient; who can answer that charge? The communists say it still allows inequalities of wealth and opportunity; who can deny it? It is urged that the democracies are not well disciplined; a defense on that score is difficult. Democracy is often not clear and stable in its foreign relations; it has severe domestic tensions; who would insist otherwise? When defensive tactics move from the realm of argument to action, they take forms which limit freedom, supplant justice with safety as an ideal, and so destroy the foundations of that which they seek to defend. In short, once democracy is put on the defensive it is lost; only when it emphasizes its positive aspects, such as freedom and justice, does it justify itself. That must give us our cue; the real subject of this discussion must be the advance toward democracy through education.

Having made that one criticism of the topic, I must, on the other hand, applaud the use of the word "education". For about twenty years now, that word has not been very actively used in connection with citizenship; men have spoken, instead, of "training" for citizenship. The difference between the two words is not accidental; it is very significant. Education looks to wisdom as its product; training seeks to produce skill. With the overthrow of the old formal discipline, there arose a marked skepticism as to whether there was any reality to the concept of a liberal education. Its outcomes were not mensurable, its traditional methods were discredited; so it came to be doubted that it existed at all. The new science of psychology was struck with the success of experiments using the conditioned reflex, and entertained the roseate hope that it was a technique of universal validity. Under such circumstances it was natural that emphasis should be put upon skills which are readily indentifiable and at least approximately mensurable. But skill has two inevitable and inescapable weaknesses as a goal. Its acquisition offers no indication that it will ever be used, for its use depends upon demand, upon attitudes and energies within the individual which are no part of the skill. The second weakness of skill is that it is ethically neutral. It may be used for personal profit and power or for public service. In itself it carries no direction. These weaknesses are the precise outcome of the study of civics, economics and current events over the last twenty years. In the Regents Inquiry study regarding citizenship, the distressing fact emerged that as the students gained information, there was a contemporaneous recession in the impulse to use the knowledge and skill at their command. In contrast, wisdom, whenever attained, functions as inevitably

as skill operates haphazardly. For wisdom is knowledge organized by oneself into meaningful patterns, controlled by disciplined emotions; it is no mere trick, like skill, but human maturity at its best. The basic technique of training, the conditioned response, has now been shown to be applicable only in limited fields, and the need for philosophical coherence among disparate skills has led to a new emphasis upon "general" education—a word substituted for the word "liberal" lest the retreat from training back toward education be too obvious.

If we are to educate, rather than train, for democracy, the first essential to wisdom is perspective. Perspective is attained by broadening and lengthening experience far beyond the boundaries, either in time or space, of the life span of an individual. It must, therefore, be achieved through vicarious experience; by imaginative processes the experiences of other people who lived before our time, and people in far regions, must be assimilated into our own lives, until they possess the vividness, the completeness, the reality of our own memories—and both must be reflected upon until they are formed by the individual mind into coherent and significant patterns.

If that is the method and the objective, it follows inescapably that remoteness in time and space has no adverse effect upon the relevance of knowledge. The thinking of Plato and Aristotle regarding democracy is as real, as valid, as informing as ever it was; and mere nearness in time does not make the views of lesser minds more important. The history of tyranny is long—even longer than the history of democracy. Its transient character, the manner in which it has always nurtured the seeds of its own destruction make it desirable to follow its record whenever and wherever it has appeared in human history.

It is perspective which reveals the fallacy of the current glib cliché about "living in a new world". The most urgent problem before the world at this moment is the issue of peace or war. Listening to current discussion, one would suspect that the Treaty of Versailles was the first instance when, in Wellington's phrase, "the fruits reaped by the swords of the victors" have been "destroyed by the pens of the statesmen." We should be well advised to remember that Armageddon is a very old word indeed. The problem of peace is as old as man, and the insistence during the last generation that students of history have been too much concerned with war and peace now bears its fruit in a generation that lacks perspective upon the exigent and terrifying crisis of today. The naïve assumption that the war to end war made mankind's experience in the search for peace irrelevant brings a stern retribution.

Perspective is the cure for overexcitement about the pressure of population. We have been overwhelmed with strident arguments about the "haves" and the "have nots"; now we are hearing about "Lebensraum". Our youth have been all of a dither about "birth control", while the totalitarians have had a reverse interest in enlarging their populations as a basis for proving they are crowded. Yet the theory and practice of birth control were the property of the Egyptians and the Greeks centuries before the Christian era. The pressure of population is as old as man.

Taxes are much in the public mind. Yet descriptions of the situation current in the third century contain most of the "new" features which concern us so deeply today. Evidences of codes based upon principles similar to those of the N.R.A. may be found centuries ago. The foreign exchange stabilization fund technique, one of the most spectacular "developments" of recent years, was practiced by the Bank of England in the eighteenth century.

It is not necessary to insist that history repeats itself; one need not take too literally the old saying, "The thing that hath been, it is that which shall be, and that which is done, is that which shall be done, and there is no new thing under the sun." Nor is one put into the position of believing that the pattern of history is "sealed" or that history reveals "laws" of universal validity. Without going that far, it is nonetheless perfectly evident that the shock and terror of incidents decline if it is realized that the same sort of thing has happened many times before, and that the world has survived. The wisdom of the remark, "This also shall pass away", is profound. On the morrow of the hurricane of last September, hysterical people asserted that "the glory of New England is destroyed", but reading the eye-witness accounts of the disasters of 1869 and 1815 shows that its glory had been impaired before; and in the smiling new spring, when so much has been done to repair the damage, the glory of New England emerges once more.

So, also, it will be helpful to perspective in these days of doubt regarding democracy to realize that democracy is not some fresh and untried invention, that it is a sturdy growth maturing through the centuries, that in Britain and America, at least, its roots have struck deep into the soil. Where there was a mere veneer of democracy, the intense heat of the World War and its aftermath has blistered it and destroyed its finish. Where democracy was grafted onto an alien stock, the graft, in some cases, has parted and the bough withered. But those events, unhappy and unfortunate as they are, do not affect the validity of its principles or the sturdiness of its growth.

If one's perspective is right, the perennial crop of Utopians, every new group of panaceas, and many catastrophic events fall each into its proper niche among transient phenomena, and not infrequently among the trivial.

It is perfectly clear, however, that perspective has not been the objective during the last two decades. The emphasis has been upon knowledge of today, something immediately useful. The social studies have been crowded with the data of the current scene and successive editions of textbooks have tumbled over each other in hot pursuit of events. Ancient history has fallen from favor, and more and more emphasis has been put upon current history, especially American history. Schools have stressed those events in "social" and "economic" history with a direct and obvious bearing upon the issues now before the public. But the material is out of focus. The simple fact is that the distant past is no more dead to youth than the recent past. If an event occurred before his memory began, distance in time need not affect reality. Caesar is no more dead than Woodrow Wilson; good teaching can make one life as real as the other. But there is one vital difference; the teacher can indicate the ultimate outcomes of the policies of Caesar, but no one yet can fully assess the fruits of Wilson's activities. From the teaching standpoint, in the effort to contribute perspective as one of the constituent elements of wisdom, the events which are long past and the ultimate effects of which can fairly be evaluated are much more useful than those recent happenings, the meanings of which belong in the realm of opinion rather than knowledge.

Distance in space has been treated much like distance in time. At the very moment when "artificial ties" with Europe against which Washington warned in the Farewell Address have been bound tightly with steam and motor vessels, airships and airplanes, telephone and radio, and on the morrow of a World War in which America's intervention is held to have been decisive, we are told that foreign languages are unnecessary. So at the moment when every school boy can hear the Pope or Hitler or Mussolini, when foreign language is heard by the citizen to an extent unique not only in our history but any history, the languages, with all their contributions to perspective, have been grossly caricatured as merely "traditional" studies, and as having no "magic"; in short, they have been treated with ridicule. The patent fact is that the voice of Hitler is as near and intimate as that of Rudy Vallee or Jack Benny. With television the dramatic events in the world's affairs will make a yet more direct impact upon daily life, and the need for perspective will become even more acute. In the artificially swift current produced by modern communication, a sense of time and change, a sense of patience and evolution, the absence of finality in any given event become essential resources of the reasoning mind.

The second constituent of wisdom, as a basis for education for democracy, is disciplined emotion—which can be described as a response to values. That ideal is as far as possible from the conditioned reflex; it is as distant as the two poles from the theory that "facts will lead to a conclusion." We may well remind ourselves once more that the Regents Inquiry found no evidence of high correlation between the acquisition of facts and the attainment of citizenlike attitudes. The students who knew what seemed terrifyingly little about community facts, such as the number of churches and newspapers, showed, many of them, a high degree of liberal response, so that the correlation between possession of data and sound response was statistically negligible. No one in his right mind would contend that the man who knows more facts is more likely to vote than the ignorant person. The power of the great political machines has not been built or destroyed by the possession or the absence of "facts" among the voters, but by their gratitude, their personal loyalty to the "boss", and their eager expectation of

benefits to come on the one hand, or their sense of duty on the other. The Regents Inquiry, to turn again for a moment to our most recent exhibit, showed, so far as it could be measured by the instruments available, an actual decline in the sense of social responsibility as the students progressed through the grades. It revealed a maturing liberal point of view combined with a falling-off in willingness to do anything to make that point of view effective in the world about them.

If we want to develop a warm but controlled emotional response, it seems obvious that we would do well to study matters into which family and environmental prejudices do not intrude, making for undisciplined emotional response. If the matter in hand is wholly detached from current interests and fixed prejudices, discipline of the emotion is facilitated. If, for example, a student reads Euripides' *Trojan Women,* he can feel the poignant situation as Hecuba looked upon the burning city she loved. The beauty of the language, its appropriateness to the thought, the depth of feeling are all as real, as moving as a news dispatch of the fall of Barcelona which I happened to read on the same day. But the fall of Troy is not encumbered with the passion and propaganda which color one's view of the fall of Barcelona. It is the most obvious teaching technique to use materials as little confused with other issues as possible. Things of the past, properly presented, are as "discoverable", as new, as fresh as speculations upon what Hitler will do next, or why the American fleet was sent back to the Pacific. The student can approach them upon an intellectual plane, make his emotional response, and then test, in the event, the validity of his judgments of value. Even in the classics, now so heartily scorned as "remote" and "dead", students may find, in high relief, the whole gamut of human passions, the whole range of human feelings. They may find men grappling with the same urgent problems the world faces today. They may find ideas as clear and thoughts as noble as those for which we are longing.

That is not the course we have followed. It is infinitely significant that we impress upon every coin, down to the penny, "In God we trust", but I have never seen it carved over the doorway of a public school. We have thought it necessary to increase instruction in economics concurrently with banishing the scriptures from the schoolroom. We have felt it necessary to pound home "the facts of everyday life", while withdrawing attention from the eternal verities. Indeed, under the dominance of economic determinism, it has been firmly denied that there are any eternal verities. In this "new" world, in this "modern" flux, anything as stable as an eternal verity becomes statistically impossible! Why anyone would expect a healthy emotional response to citizenship in a democracy to develop in that atmosphere is difficult to imagine.

When Bishop Grundtvig and his disciples sought to reawaken Denmark and set it upon a new course, they did not attempt it by showing all the weaknesses and shortcomings of the policy that led to defeat; they did not dwell upon the rape of Schleswig-Holstein, or the loss of two fifths of the land, or economic doctrine, or even social amelioration. Instead, they carried the peasants back to the folk songs, the old legends, the stories of ancient days, to the wisdom of the ages. They sought to inspire these beaten youth, to reawaken courage and the spirit of piety. Christian Kold exclaimed once, "When I am inspired I can speak so that my hearers will remember what I say even beyond this world"! Their aim was much more the discipline of the emotions than "facts" or "information" or knowledge interpreted in such terms. With sure insight they saw that if minds were stimulated, if hearts were warmed, the acquisition of knowledge and the formulation of policy could take care of themselves. The event proved them abundantly right.

The process in America has been the precise reverse. We became afraid of emotion, regarding it all as "sentimental". Even art had to have a "message"; if it was beautiful, it was damned as "prettified"; if it did not show the garbage can, or structural and human dilapidation, it was not "honest". The accent was heavily upon the triumph of ugliness—muckraking on canvas. We have passed through an era of hero smashing. Biographers have tapped youth's idols to show their feet of clay. Some years ago two biographies of Washington appeared almost simultaneously, both devoted to "debunking" the first president. The Constitution was interpreted as the result of an effort of speculators in government bonds to make good their gamble. From Gladstone's magniloquence about that instrument to the modern version of its

provenance, the descent has been from the loftiest ideal to the level of a sordid transaction. How that may win devotion has not yet been shown. The emphasis has been shifted from the triumphs and advances to shortcomings and failures. We hear no more of the rise from the cabin to the presidency, but of the "lost generation", the "tragedy of youth". We hear less and less of the gifts the industrial revolution has brought and more and more of technological unemployment, until fear rather than courage is the emotion aroused. Because of alleged fear of a "sentimental" view of the past, we have interpreted spiritual achievements in materialistic terms. Poetry has been interpreted merely as "response to environment" rather than a profound emotional insight into truth. Determinedly the story of the race, on its social and political side, has been robbed of the sense of victory and achievement; it is all too often interpreted as a record of exploitation and frustration. The only "success story" presently popular in the schools is in the non-ethical or ethically neutral field of science, which with even hand serves the will bent upon constructive effort or destructive purpose.

Democracy, indeed, has been criticized for not giving "security". If one seeks to discipline emotional response for life in a democracy, security is the worst possible ideal. When Wilson asked for a world safe for democracy, Gilbert Chesterton retorted, "Impossible; democracy is a dangerous trade." So it is; if it does not live dangerously—giving its enemies great freedom—it does not live at all. Talk in a world of action is dangerous; to guarantee freedom of expression to thoughts we hate is dangerous. To permit vigorous opposition in a world of blood purges, political assassinations and concentration camps is dangerous. But that course of action, with all its dangers, is the price of democracy. Safety first is an idea corrosive of democracy. Safety is not the goal, but the realization of the dignity of mankind. That requires the pursuit of many ideals; their pursuit is always and inherently hazardous; to set safety above them ends the pursuit before it is fairly started. It is therefore no accident that an age which has made "social security" a fetish, an age which seeks to escape the hazards of life, has not been effective educationally in forwarding the democratic ideal. Democracy is a great human adventure, and only the adventurous spirit makes it possible. The sense of adventure is an emotional matter, and education must deal constructively with the emotions as well as the intellect.

Wisdom is not easily acquired. "For at the first she will walk with him in crooked ways, and will bring fear and dread upon him, and torment him with her discipline. . . . If he go astray, she will forsake him, and give him over to his fall." Patience is necessary, but industry even more so. That is the third constituent of wisdom, of which I would speak. Yet the virtue of hard work is selling at a serious discount in the schools. So meanly do we regard our children that one of the commonest assertions is that the disciplines which have long charmed the mind of man are "too hard". They may be made, by uninspired teaching, to seem irrelevant; they may be made distasteful, but they are not too hard. Schools, doubtful of their own programs, schools crowded with students "kept" in school by legal compulsions, schools under political pressure to "pass" students, schools suddenly supersensitive to the psychological injury involved in failure have tended to substitute less arduous and infinitely less significant materials of instruction. It is a self-defeating program if wisdom is the goal. Failure is one of the common, one of the inescapable experiences of life. Learning by industry and forethought to escape it is one of life's great lessons. To short-circuit that lesson by abolishing failure by edict, as has been done in many public school systems in the United States, is to give a false definition of success and to lend an illusion of achievement where none exists. Such a course of action, whatever the motives, must put industry at a discount, just as blaming things on "society" relieves the individual of a sense of personal responsibility. The substitution of data-laden courses for the disciplines, of the motive of gain for the motive of service, of materialism as an explanation of reality for idealism, the desire to be supported by the state instead of supporting the state, all these rot away the incentives to industry.

No one in his right mind wants to abuse the youth of today, but we are in more danger of killing them by mistaken kindness than by overwork. They have been largely freed from economic effort; indeed many avenues for experience in economic

self-reliance are closed to them by law. They are transported to the school house if distances are involved. They are furnished with books and materials that once were hard to acquire. All those things are desirable, but only if, in compensation, it is recognized that they have released time and energy for the use of education. If those gains are frittered away, there is no real gain at all, and kindness becomes betrayal.

Much can be done by the use of modern devices to facilitate instruction. But when the last movie reel is back in its tin box, when the radio is turned off, and all the sugar coating has disappeared, the process of learning remains difficult. Whoever pretends it is easy attempts to cheat. Any procedure which miscalls failure success prevents education. Any refusal to make the boy face ideas because they are harder to grasp than facts results in simply stuffing him instead of educating him. Any pretense that the material can really be "correlated" outside his own mind misleads him.

Learning, the use of the mind, is hard work. It requires industry of a courageous kind. I have seen many a boy who would sweat all summer building roads quail before a book. But books must be faced; and even worse awaits. What is there must be remembered and reflected upon until it is no longer a piece of a book stuck in the mind, but until the ideas have been digested and are an integral part of the mind, just as food well digested becomes part of the body. Admittedly there are some of such feeble mentality that they cannot learn. But there is more danger of mistaking laziness for stupidity than of overworking the feeble mind.

Democracy is the most difficult, the most dangerous form of government. It achieves progress the hardest way, in the belief that the process is as important as the result. That process is the realization of the fullest potentiality of each citizen—not merely his most convenient use by the state but his richest self-realization. To that end the state, in normal times, waits upon his voluntary activity for the solution of its hardest problems. Democracy seeks to fulfill an ancient ideal: "The multitude of the wise is the welfare of the world." That ideal cannot be achieved by training for skills alone, but it may be attained by education for wisdom—through perspective, response to values, and industry.

Remarks by the Chairman

Chairman Coudert: What a delight to hear a scholar, a man with a perspective of history, speak to us in these days when every sort of quackery and nostrum is spread out before us. That, indeed, was a most informative and stimulating address—I think I am speaking for everyone.

If there are any people who need education, surely they are our legislators in Washington! I say that without any tinge whatever of irony, because they have a much larger responsibility in the government of our affairs than we, and they should be better educated than we insignificant citizens need to be.

I take it that those legislators have, at least, this advantage: When they get their coffee in the morning, they also receive the morning *Post.* I do not say that I always agree with the matter that I find there on my occasional excursions to Washington; but we are fortunate in having with us the associate publisher of that influential and important journal of opinion, which has in it such potentialities for education, Mrs. Eugene Meyer, who will speak to us on "Freedom of the Press, Freedom of Speech and Religious Tolerance"—than which there are no things more important.

FREEDOM OF THE PRESS, FREEDOM OF SPEECH AND RELIGIOUS TOLERANCE

MRS. EUGENE MEYER
Associate Publisher, *The Washington Post*

THE Bill of Rights, which prevents Congress from passing laws that will interfere with freedom of the press, speech and religion, is of such enduring importance because through it a democracy recognized and protected for the first time, and let us hope for all time, the spiritual and intellectual freedom of the individual human being. It invites the inner and the outer man toward action—it encourages self-criticism and self-discipline. It is the guarantee of free enquiry and therefore of all genuine progress. It has done as much as the Constitution, itself, to further the development of our people and our country; its existence as a part of our fundamental law makes of America a country that differs in its moral and mental atmosphere from any other country in the world. It is the light of life and of human intelligence. It is a bond with the Absolute and a pledge of faith in mankind. As long as these solemn promises to God and our fellow man inspire our thoughts and actions, we shall remain a people blessed by the spirit of truth and guided by the power of reason.

It is greatly to the credit of our country that since the Bill of Rights was written, there has never been a formal restriction upon the freedom of religion, and on only four occasions a temporary limitation upon freedom of speech and of the press. The first occurred during the French crisis in 1798 when the Alien, Sedition and Naturalization acts were passed. The second was when the slave controversy resulted in severe restrictions on the press and free speech in the South; the third took place during the Civil War, and the last and perhaps the most drastic during the World War. The most reliable students of history are agreed that not only did these restrictions not accomplish what they set out to do, but that the results of these attempts at repression were baneful from both a practical and a psychological point of view. Professor Henry

Steele Commager, who recently published in *The New York Times* a careful review of each of these instances, concludes:

> If there is any moral to be drawn from this historical review it is that suspension of the Bill of Rights, even in the face of emergency, is neither necessary nor wise. Such suspension has not, in fact, contributed to the ends which were in each case sought; the preservation of the nation and of the Constitution. It has, on the contrary, tended to obscure the issues which were at stake, to embarrass spokesmen of democracy, to discourage champions of orderly government and to encourage lawlessness. For it must be apparent that to nullify freedom of speech or of the press is to confess that our cause cannot stand examination or criticism; it is to substitute arbitrary power for reason.

Why then have these freedoms become debatable once more? Primarily because a large part of the world has suppressed them, but also because our own country is experiencing overt and concealed attempts to place limitations of speech upon groups of our citizens, because racial and religious hatreds are being fomented by numerous organizations in the name of democracy, and because even more insidious attempts are being made to hamper criticism by pressures of one sort or another.

But all these factors are chiefly significant because they are but surface symptoms of a far greater danger, namely, of a deep insecurity that now resides consciously or unconsciously in the heart of every American. The courage to permit free speech can reside only in people who feel themselves genuinely free within their own hearts and minds. It cannot exist in men and women whose utterances are hampered and whose thinking is confused by a lack of inner conviction and clarity. Free speech is for a free people, and temporarily we are not sure of ourselves, of our aims and methods, whether political, economic or moral. We are betrayed by what is false within.

For individual security and freedom can be had only when the relationship of the individual to society rests upon a rational basis that is not only clearly understood but that lives as an active force in the feeling-tone of every man, woman and child. The extreme examples of this lack of relationship to the social structure are of course the millions of unemployed and their even more numerous dependents, but the thing that our country finds it hard to face is that what is true for these unfortunates is equally true for every thoughtful and conscientious citizen. A democracy with twenty million wards among its population is not a democracy. The problems of these victims of our economic system is the problem of the whole nation. Those who are more fortunately placed try to dull the agony of this realization by doing their duty, as they see it, for the common good, but fundamentally they are all of them just as shaken, just as frustrated by this fact as the men who wander about the streets with no hope and often no place to lay their heads.

The real reason why the dictatorships are temporarily powerful, the reason why cowardly souls amongst our own people look enviously at these governments, is because under dictatorship the individual human being is tied closely to the nation and feels that he has a function and even a mission in life. The myths that bind him—for they are myths—may be without much immediate hope as in bureaucratic Russia, or they may be positively evil as in the amoral and militaristic program of Germany and Italy; but we have every cause to fear the might of those states because it rests upon the unity of their social structure; and artificial and bad as that unity may seem to us, it will not be shaken until a new and more acceptable basis for the common relationship of men can be found by those peoples. For man cannot endure life as an isolated being. He derives his human significance from his relationship to society; if he cannot find a sound basis of relationship, he will manufacture an artificial one. But real or imaginary, he will cling to that social philosophy until he is offered a better one.

The only honest solution, the only way in which we can recapture our sense of freedom, lies in a new integration of the social structure wherein a new morality can express new definitions of property rights. A way must be found whereby growth in the efficiency of production will increase the universal opportunity for social freedom and economic improvement so that all of our citizens will again feel themselves an integral and necessary part of the social unity. We must reëstablish a world in which a man's destiny is determined by his own ability and efforts, for that is the only possible basis of democracy. Nor is the economic bond of the individual to the group by any means the whole answer. We must go further and create moral and spiritual bonds as well. The economic structure must become a means to higher ends and not remain, as previously in our nation, an end in itself. But the economic solution must come first, for it cannot be expected that a disaffected, undernourished and rebellious people will struggle for the self-discipline and self-control which are the ultimate test of the democratic way of life.

If we view this need for the reintegration of our social structure from another angle, it should be pointed out that we are so concerned about the problem of freedom today, not because we have too little freedom but because we have too much. For freedom implies limitations and boundaries. Without them it becomes chaos and anarchy and leads to loss of all freedom. Truly progressive freedom can only be established by a firm social structure, in relation to which the individual understands his own stature and meaning. The social structure defines the relationship of freedom to necessity by establishing not only the privileges but the responsibilities of freedom and by suggesting the inner controls, the moral relationship of man to man. Morality is largely the interpretation by the individual consciousness of the patterns of society, and moral leadership represents the highest conscience of the country as a whole.

In this moment when society is in a fluid state, the press, it seems to me, has a responsibility to democracy never before equaled. It must represent moral leadership, the conscience of a free democracy at its highest and best. It must do its utmost to bring about and to guide the realignment of the social structure which is now taking place in a haphazard, hit or miss fashion. It must recognize that juster social and economic provisions are the prime challenge of the day. On this point there must be no timid equivocation and no concealment. Some members of the present government have expressed disapproval of the press because of its opposition to various administration measures, but in its criticism of government officials for their careless handling of relief and for their failure to deal effectively with the unemployment problem, the press has actually been much too lenient. The first duty of all alert and disinterested newspapers is to keep this dangerous situation foremost in the public mind until an indignant popular opinion forces more efficient action in regard to this central flaw in our national structure. Postponement of this essential solution saps our vitality, and dishonesty concerning it makes us hypocritical at a time when we need all of our vigor and discernment to answer the threat of rival forms of government.

Above all things it is the high responsibility of every paper to encourage clear and courageous thinking by giving all the facts, and by printing the news accurately and without bias. A newspaper is not merely a private possession. It is a public responsibility. In the news columns it must maintain its objectivity toward the national life and toward national and international politics. Without this objectivity it will cease to be an end in itself and become a mere tool of private purposes. It must be able to see all sides of every question and allow the facts to speak for themselves.

Only in its editorial pages should it present its own point of view and that also should be reached objectively with nothing in mind except the public welfare. Here also a judicial attitude must be preserved and a continuity of policy maintained, indicative of real knowledge of the questions involved, their historical background and their bearing upon future trends of development in the social, economic and political field. This editorial responsibility is a heavy one, and I take pride in stating that this is nowhere more deeply felt than on the staff of *The Washington Post.*

And day in, day out, the press must defend democracy on every front, in the political struggles of its own community, as well as in major questions of national and international policy. It must defend individuals and minorities against oppression, must be just in its reports of labor problems, and fair toward public personalities under all circumstances. Moreover these serious matters and complicated issues must be presented in such a way that they are concise, clear and readable as well. This educational aspect of journalism is one of the most important, and its rewards are great, for the common-sense and fair-minded reaction of the American public to any of its problems can be counted upon as long as the problem has been clearly and simply stated.

When the confusion in which we live makes such serious demands upon the leaders of the press, it is only natural that some should fail in their high responsibilities, but on the whole our newspapers are the best in the world. When it comes to justice, freedom from prejudice and devotion to the public good, they certainly compare favorably with any other profession. The frequent accusation that our press is unfair because it is controlled by selfish-minded capitalists is based to some extent upon a type of journalism that is now fast disappearing, largely because the American public is too intelligent and alert to continue its support of papers which it distrusts. Even the most reactionary managements are finding out that it pays to be interesting, and no paper that is biased can hold the interest, to say nothing of the respect, of the American reader.

The idea that the press is dominated by its owners is actually untenable, given the conditions of modern journalism. A newspaper of distinction and character can never be a one-man proposition but must be the result of team work. The constructive publisher must draw out the capacities of his fellow workers from the editor to the last mechanic, if the results are to be good. If these men are repressed by orders which they cannot respect, they become rebellious and frustrated. But when full trust is placed in them, they are encouraged to merge their best in a mutual understanding and then only can a paper develop that personality which attracts and holds the support of the reading public.

The press, to be sure, depends for its continuation on its commercial success and I hope this will always be so, for this removes the temptation to accept subsidies. But in addition to being a commercial venture, it is also a public utility and as such it depends on public satisfaction. It is, therefore, sensitive and responsive to criticism not only from groups but from individuals as well; as our papers now stand, they are a joint venture not only of the publisher and his associates but of the management and the public, and nothing has been more salutary for the press as a whole than the barrage of criticism to which it has of late been subjected. But the public would do well to bear in mind that in a field so sharply competitive, the inferior papers drag down the standards of the good ones, and public approval, when it is merited, should also be freely expressed because this helps the good papers to live and to go on improving their standards.

The modern mechanized press is only in the infancy of its development but as long as it continues to improve its standards, as long as it seeks to give an uncolored and full report of the news and continues to develop a free and untrammeled attitude toward the social developments now taking place, it is the

greatest asset the nation possesses in the struggle for democracy and we need have no fears for its freedom. The very fact that Hitler seldom makes a speech without attacking furiously what he calls the mendacious American press proves that the steady and incisive criticisms of our newspapers are getting under his skin, perhaps more than any other single external force with which he has to contend.

But the question arises in many minds whether other elements, more irresponsible than the press, the Communists, or the Nazis, who use our democratic freedom to spread their anti-American doctrines, should be allowed to express themselves freely under present circumstances. As a matter of fact we have always had extremists of this sort in our country without paying more than a desultory attention to them because we, ourselves, in former years were more certain of our democratic ideals and principles. The wonderful thing about democracy, one of the reasons it works so well, is that extreme opinions tend to cancel each other out when they do not actually fall upon deaf ears. This leaves the balance of power with the middle-of-the-road, sensible, intelligent, open-minded citizens. But today such fears as we have of the lunatic fringe arise out of our own insecurity whose main origin I have tried to point out. In our normal, poised, perhaps too sanguine, American frame of mind, communism would seem to us pathetic and nazism would appear ludicrous, if not touched with madness. But today we are sensitive to the slurs of these people on democracy and have an instinctive desire to suppress them because we lack our customary inner self-assurance. If our inner controls were as strong as they ought to be, we should be less tempted to use outer controls to silence people who disagree with us. But freedom of speech, we must remember, does not apply only to the wise and the well-meaning mentalities. It applies also to the foolish, the misguided and the ignorant. Tolerance in listening to an opponent is as important an element in free speech as any other; perhaps the most important. The essential good nature of the American disposition and our naturally steadfast characters should not give way to the exasperation which indicates frayed nerves. If we succeed in retaining our characteristic tolerance, our habitual firmness of character under the present ordeal, then to quote Emerson,

" the most confident and the most violent persons will learn that here is a resistance on which both impudence and terror are wasted."

For what we are actually in need of today is not less criticism but better, more truly incisive and more constructive criticism. We have heretofore been, largely, a race of self-satisfied Pollyannas who looked upon the criticism which we often got from foreigners as so much jealousy. We had a conviction that democracy would automatically continue to supply the material things of earth in ever greater abundance and that our formula for life would be revealed to the other nations of the earth as soon as they were able to catch up with our happy mixture of representative government and industrial organization. When for reasons that are still unfathomable to most of us, the recipe did not work abroad, we were first impatient, then resentful, and now we are becoming bellicose, when what is actually needed is a close attention to our own inherent and historical shortcomings.

The Bill of Rights, I have said, implies the guarantee of a free critique of our national culture and our political institutions. Thus the development of a deeply critical attitude becomes the inescapable responsibility of the citizens of a democracy, and never have we been in more immediate need of it. The newspapers of the country should never be attacked because they criticize. They should rather be challenged to reach higher and deeper in visualizing what kind of a future we wish to build. Then we should be giving utterance to voices that are truly free. Perhaps what we need is less talk and more reflection, more factual consideration, more imaginative thinking. For free speech can be a menace instead of a blessing when it degenerates into a meaningless din of voices.

If I seem to be making a plea for greater depth and harmony in the voices that we raise, let me recall that harmony is not uniformity, that, indeed, it can best be obtained through the fusing of sharp dissonances that resolve themselves only to give way to new varieties of opposition in tone. The harmony which is attained by force under dictatorship can never successfully compete for the allegiance of the human heart with the true music that results from the temporary solution of the honest differences of men who speak their minds freely. Nor

is it an accident of history that the human race fought and died for thousands of years to acquire this freedom. Equilibrium—and equilibrium is the physical aspect of freedom—as the result of opposite forces is the law of human nature, because it is the law of nature herself. All human individuality, all art, all culture arises from this same source. Each one of us can never be more than the repository of but a small portion of the truth—and the instinct to arrive at universal truth through the conciliation of opposing aspects of truth is as profoundly natural to our souls, as it is for nature to progress through the union of different sexes and species. Or to speak architecturally, a nation like any building stands because the opposing stresses and strains are equalized. This law of life and of gravity cannot be suppressed by dictatorship, however mighty it may seem temporarily. A nation or a building in which all the forces pull in one direction can be artificially propped up for a time, but before long it will inevitably collapse. The dictator is forced to substitute dynamics for poise, because he knows that he can never rest secure upon his unstable foundations. Once his movement is really impeded the whole system will crumble. And even if he makes the challenge of war, it cannot be long sustained because of the inner weakness of his social structure.

Let our minds be confident of this truth. Liberty and progress, as the fusing of opposite forces, is the law of life itself, and the greatest natural force in the world. Whoever dares to suppress freedom in one part of the world only gives it a fiercer intensity where the outlets still exist. At present the wise guidance of that greatest of human forces is the responsibility chiefly of the American nation if only because here life is less threatened, less restricted than anywhere else. Life is heavy and turgid for most of our fellow men, but here it is still free to be creative, to open large vistas of human happiness, and we owe it not only to ourselves but to a despairing civilization to find new formulas for a just and workable society.

I said at the outset that the Bill of Rights is also a bond with the Absolute. The guarantee of the freedom of religion is a recognition of the fact that man is inviolable, that however important his relation to society may be, he also possesses an inner life for which he is responsible to God alone. And there, I think, we hit upon the real reason why the American recoils and always will recoil from the brutal menace of the totalitarian state. For dictatorship threatens the soul of man. It lays claim to the whole of him for the society of which he is an insignificant part. It treats the individual with contempt. It despises him. Never has the President of the United States made a more important utterance than when he reminded this nation of the indissoluble relation of democracy and the religious spirit. Allow me to recall his words for we cannot repeat them too often:

> Storms from abroad directly challenge three institutions indispensable to Americans, now as always. The first is religion. It is the source of the other two—democracy and international good faith.
>
> Religion, by teaching man his relationship to God, gives the individual a sense of his own dignity and teaches him to respect himself by respecting his neighbors.
>
> In a modern civilization, all three — religion, democracy and international good faith—complement each other.
>
> An ordering of society which relegates religion, democracy and good faith among nations to the background can find no place within for the ideals of the Prince of Peace. The United States rejects such an ordering and retains its ancient faith.

Yes—we retain our ancient faith in religion, in freedom—but what we have inherited from our fathers must now be recaptured; it must be earned again if it is to be preserved. We shall have freedom of religion as long as we retain within our breasts the sense of awe and of worship. We shall have freedom of the press as long as we rely upon the power of reason and insist upon facts as the basis of our conclusions. We shall have freedom of speech as long as we have truths in our hearts so compelling that we would rather die than be silent.

Remarks by the Chairman

(Dr. W. Randolph Burgess, President of The Academy, assumed the Chair)

President Burgess: Thank you, very much, Mrs. Meyer.

As you know, it is the custom to have informal discussion at the conclusion of the set papers. The discussion today will be opened by Mr. Leland Stowe — a name known to all of us for his articles written in Paris for the *Herald Tribune*. Mr. Leland Stowe!

PREPAREDNESS AND FOREIGN POLICY: DISCUSSION

LELAND STOWE
Of the *New York Herald Tribune*

A few days ago, I got one of those inside bits of information which sometimes come to us as newspaper men. I was informed that recently Mr. Neville Chamberlain had a nightmare. He dreamed that he was addressing the House of Commons—and then he woke up, and he was!

As I have been sitting here I have been reminded of that story, because actually I am in the position of the old-fashioned caboose which got hooked on by accident to a new streamlined train. But I am supposed to act like a caboose, so do not be alarmed.

I do want to say just a few words. Going back to our foreign policy, because it happens to be down my alley, there are a few questions which concern our own problem in regard to the next world war: If it comes, can we stay out? And if we can not, on what terms are we going to go in?

Shortly after Munich last fall, a distinguished Britisher came over here and was very much surprised by the strength of the revulsion in this country against the Munich deal. I think a great many Englishmen have been surprised about that. This man was talking to Professor Charles Beard, and he said, "Now really, Professor, what about this tremendous isolationism you have over here? I really don't understand it."

Professor Beard replied: "Ignorance, my dear sir—sheer ignorance. We haven't the slightest idea what your government is going to do next."

That realization seems to have been gradually sinking in, in London in the past six months. I must agree with Raymond Swing, that our government has had a good deal to do with putting some backbone in Mr. Chamberlain, or his umbrella—either way you want to look at it. In any case, we surely have been responsible for quite a lot of stiffening on the other side. But it was not merely Washington.

Why have the British turned from appeasement to a sterner stand? Of course, for their own selfish reasons, as is always true; but I think also, as far as we are concerned, they have made that change because they are beginning to depend on our going into the war to help save them from whatever they have to face. Impressed by the tremendous revulsion of American public opinion against the immorality of what happened to Czechoslovakia, there has been a realization, I think, in Mr. Chamberlain's section of English opinion, which is not the majority—I think we all hope there has been a realization—that if the United States was going to march along, then there would have to be a different kind of policy. After all, the King and Queen are not coming over just to look at the cherry blossoms in Washington!

I believe I am in the situation of a great many other Americans, and that is this: I most heartily dislike the dictators of Europe, and I have seen what they do to people who are fighting for their own freedom; but I also most heartily dislike Mr. Chamberlain's policy and that of M. Bonnet. Yet, I do not want us to go into a war.

That is a nice dilemma, is it not? I am trying to figure it out, and I do not like my results any too well, and I do not know how I may feel about them later on. It seems to me, first of all, that what Munich means to us as Americans is that our children have actually been drafted by the Chamberlain and Daladier governments to take the place of two million Czechs. Inasmuch as they have been drafted already, in the sense of what may be the force of necessity, to that extent at least we are very deeply involved and concerned.

As one who believes in international coöperation, when it is tried, I must say that I think the President's policy, in sending his note to the dictators the other day, is the only way to keep a man like Hitler from adventure. By washing our hands completely, we would only make Hitler the more audacious and unpredictable. On the other hand, however, I do not like the idea of dying for Mr. Chamberlain's conception of democracy, and I do not want my boy to die for it—do you?

Well, what are we going to do about it? Maybe we are going to have to go in on that side. Maybe we shall have to make that eventual choice. I am wondering, however, whether

we are going to be swept along by the same old slogans about saving democracy.

I lived in France for nine years, and I have many friends there. I am sympathetic to the French people in many ways, but since Munich and since Barcelona and Madrid and the rest, I am not so certain. Even so, you can talk me into fighting Hitler very easily, because I do not like what he stands for.

So here I am—a nice example of the typical American dilemma. This much I have been able to figure out (and I have not figured much, I am afraid): We must ask ourselves what kind of allies we are going to have. We must ask ourselves, if we are going in, what kind of peace we are going to make.

When I was at Wesleyan University there used to be a young history professor who was extremely popular—we knew him then as Hank Wriston. Along about that time we used to be studying war aims—at least I was. Well, what are the war aims in the next war going to be? If we have to go to another Versailles, what are we going to do?

It seems to me that we have to prepare ourselves in advance. If the British and French are asking for our material support, which leads toward active intervention, if we may be driven to intervention physically as well as by economic and financial contribution, then should we not now begin to pose our conditions? Should we not ask certain realistic questions of those with whom we might be associated?

I do not think for a moment that we should go into another war without asking the British government (particularly if Mr. Chamberlain is still there with his head out from under his umbrella) some realistic and very embarrassing questions: "If the United States enters the war, Mr. Chamberlain, do you agree that Great Britain will not accept any territorial aggrandizement from this war? If the United States enters the war, M. Daladier, does France agree to the same? Do you agree that the German people, regardless of revolution or whatever turmoil develops in Germany, will themselves decide what kind of government they will have?"

If we are going into the next war, we should ask ourselves whether we are willing to abide by the revolutionary verdict which is apt to engulf the whole of Central Europe. Are we willing to let the Italian people, if they are driven to it, accept a Marxist state which the majority of them may want? Are we willing to have communism in Germany?

In other words, the business of what we are going to do with Europe imposes most serious responsibilities and questions as to what we stand for before we ever send one soldier over on a boat. I think it very important that these questions should be answered by all of us now, and most certainly that our officials in Washington should be puzzled and embarrassed by them. We ourselves should find out whether or not we are ready to accept the responsibilities we must take if we try to stop Hitler. As Raymond Swing so splendidly and so truly said, it is not enough to stop him; there is going to be the kind of world that is left when you get through stopping him.

That, I think, is a question we have got to answer. What kind of conditions are we going to impose if we are dragged in? I think we need a lot of debate on that subject. I would also say most earnestly that I think it imperative that we have the nationalization of our own munitions industry, and a very rigid restriction put upon all profits during the period of a war.

These are things, I am sure, which will have some effect in keeping us from being drawn in. Yet they ought to be debated, it seems to me, much more than they are.

I hope you will forgive this rather rash excursion. It is not a well-rounded plan. I am simply trying to throw forward a few ideas, and to leave you now to carry on.

PART II

THE PROBLEMS OF PHYSICAL PREPAREDNESS

INTRODUCTION *

SHEPARD MORGAN, *Presiding*
Vice President, Chase National Bank of the City of New York
Trustee of The Academy of Political Science

IN opening this second session of the Spring Meeting of the Academy, I think that it might be interesting to recall the conditions under which the Academy of Political Science was first imagined. The late John W. Burgess, the distinguished Dean of the Faculty of Political Science at Columbia, was in his younger days a soldier in the Union army during the Civil War. The story goes that on a winter night in 1863 he was doing sentinel duty on a battlefield near Davy Crockett's Fort in western Tennessee. As he kept his lonely watch, he began to meditate, and his meditation ran somewhat in this way: Why am I here? Is it not rather ridiculous to have to settle on the battlefield these questions, which after all are differences between human beings and perhaps can be rationally solved? If I ever get out of this war, I shall try to found a new institution in which it will be possible to talk things over deliberately and calmly and so prevent conflicts between human beings at home and, eventually perhaps, conflicts between nations.

In this spirit of free discussion we are met this afternoon to consider the general subject of Preparedness, particularly in its material aspects. I have some thoughts here which run as follows: The genius of man has brought the nations of the world closer together than ever before in all human history. The wonders of modern transportation and communication link

* Opening remarks at the Second Session of the Semi-Annual Meeting.

together the peoples of the six continents with bands which all but annihilate the ancient barriers of time and space. The coming of the machine age, the rise of the modern industrial methods, the developments of science in a thousand fields have combined to create a vast interlocking system of production and distribution in which the disturbance or breakage of one part affects in greater or less degree all the others. Yet science and the machine age and the genius of man have also improved and extended in speed and range and power the instruments of force, the means for the destruction of the wonders man has in other ways achieved, the means perhaps for the eventual self-destruction of man himself and all his vaunted civilization.

And this supplementary thought: " Thus is made clear that those people who live at peace, disclaiming all purpose of aggression, must nevertheless take note of the doings and character of neighbors perhaps otherwise minded; that for the time being the policy of peace by international agreement has failed; and that the nation which would preserve its institutions, its dignity, and its rights in a world where all too obviously force still rules must walk amongst its fellows 'with sword on thigh and brow with purpose knit'; must, in the trenchant phrase of Guibert, 'make its arms to be feared, though never its ambitions.' "

I didn't write those words. I wish I had. They were written by our distinguished next speaker, Major Eliot.

THE MILITARY POSITION OF THE UNITED STATES

GEORGE FIELDING ELIOT
Former Major, Military Intelligence Reserve, United States Army

IN the very brief time at my disposal it is not possible to cover so broad a subject as " The Military Position of the United States " in anything but the briefest outline. We speak in general, when we consider these matters of national defense, and I think that we ought to have a very clear idea of what we mean by defense. Too often the word " defense " is translated into an idea of standing on our shore lines, gun in hand, to repel any enemy which may appear. To defend oneself, of course, is a necessary purpose. We must as individuals defend ourselves against many things, not usually under civilized conditions with gun in hand. It is not so with nations. Nations must be prepared for a much more vigorous form of defense, and when we in the United States speak of defense, of course our purpose in maintaining military establishments at all is the defense of our liberties, our free institutions, our possessions and the economic conditions under which we find it best to live.

If in defending these things, it comes to fighting, as we all hope that it will not, but as history shows us that it may, then the best defense possible is to make whatever enemy we are facing desire very earnestly to cease his efforts to deprive us of any of these things. And that is best done by attacking his vital interests and giving him neither time nor opportunity to attack our vital interests.

Because of our geographical position, this, applied to American conditions, can mean just one thing. It can mean only a vigorous offensive attitude upon the sea. We are not able to attack any other Great Power in any other way than by an attack upon its sea communications, always of course presuming that we have no allies whom we are trying to support on the continent of Europe or in Asia, as we did in the last war. We have to think of these strategical situations in connection with this term "defense", for national strategy must always go hand in hand with military policy, military policy being constrained by strategical considerations and providing strategy with the instruments for the execution of its missions.

Strategy is the art of the commander. It is differentiated from tactics because tactics is the art of maneuvering troops on the battlefield or ships actually in the presence of the enemy, while strategy takes in the wider scope of the use of armies, navies, and indeed of economic power in the furtherance of the national end.

But military policy, which is the policy adopted in time of peace, looking toward those ends which we generally group under the head of national defense, must also go hand in hand with foreign policy; for, in a world which unfortunately today is ruled by force, foreign policy must always take account of the ability of military policy to support it, and military policy must likewise take account of the demands which foreign policy may make upon it. Thus, it is clear that these two must be closely coördinated and harmonized with national strategy; since strategy is the means by which military policy seeks to execute its missions, our foreign policy must not neglect strategical considerations.

Now strategy is very largely a matter of geography; every nation must have its own national strategy. Considering our own military position and our geographical situation, what sort of national strategy do we find imposed upon us, and what differentiates this from the strategy of other states? Looking across the Atlantic Ocean at the nations of Europe, we find that with all of them today the first consideration is defense against air attack. The air weapon has brought about a complete alteration of the military situation of Europe. Where formerly, for example, strategical surprise was impossible because of the tremendous effort and time which it took to mobilize the great armies of Europe, today any nation of Europe within reach of the air bases of an enemy may be surprised out of any morning sky. Therefore, those nations who have aggressive purposes and are achieving their ends by force of arms or by the threat of armed forces are placed in a

peculiarly advantageous situation, because they now have at their command a weapon which can terrorize not only governments, but the civilian populations of those nations at whose expense they intend to advance their ambitions.

The United States is the only Great Power which is not in this situation. Even Japan has modified, one may suspect, its attitude toward the Russian government because of the fact that its cities are peculiarly exposed to the use of incendiary bombs and are within the reach of Russian air power at Vladivostok. The United States, however, not only has no powerful military neighbors who can invade its territory with great armies, but is also out of reach of the air bases of any Great Power which might conceivably become a serious enemy; and our security is bound up in the first place with the exclusion from the western hemisphere of such air bases. It is true that certain European nations, Great Britain, France and the Netherlands, do have certain possessions here. None of them, however, has any air establishment of a military sort, unless you can consider the Canadian air force as being a British air threat, and I do not think that it is in any way a threat to us, or ever will be.

The primary factors in our military situation, upon which we must base all of our considerations of national defense, are the Atlantic and Pacific Oceans, which, by dividing us from the other Great Powers of the world, make the control of sea communications the first consideration in our national strategy. Bombing planes cannot fly across these oceans with bomb loads. Not within the foreseeable future will this be a practical military operation, because even if an airplane is designed, which it has not been as yet, to carry a load of bombs across the Atlantic Ocean from Europe to the shores of the United States, and there drop its bombs and return—even were this so, all the experience that we have had in Spain and China and the World War with bombardment aviation makes it perfectly clear that either for any serious effect on civilian morale, or for a serious demolition effect against great cities or industrial centers, you must have continuity of effort. When you come to making the number of planes that you would require to fly over a three-thousand mile course and get any continuity of effort, any continued attack—such as an artillery bombardment, for example, can give you—you get into astronomical figures, you get beyond the power of any nation to create such a force. Therefore, the approach of air power or the approach of invading armies to the western hemisphere, to the United States or to any of our neighbors, begins necessarily with the conveyance of these forces in ships and the establishment of bases for their use in this hemisphere.

Our primary defense against such procedure is the possession of a fleet adequate to command the sea communications by which such a danger must approach us. But the fleet is by no means all that we require. The fleet must be at a proper standard to enable it to deal with any conceivable enemy. It also requires bases to enable it to act in any part of the oceans where our interest may call it and these bases must be defended. They must be defended by troops able to secure them against any sort of attack that may fall upon them in the absence of the fleet, and they must be defended by air power which can protect them from air attack and also, in many instances, can undertake offensive operations (limited, it is true, in extent) over the sea in the absence of the fleet or in support of it. Indeed, a study of how air power has changed the former conditions of sea warfare is one of the greatest interest for America. We may have to defend one of our maritime frontiers while our fleet is on the other, for the fleet must never be divided. In that case, long-range bombardment aviation would be one of the most important factors in such defense.

Aside from the defense of naval bases, we require an army which is capable of carrying out expeditions of a limited nature such as the seizure of an advance base for the fleet, the protection of some particular point which may be menaced by an enemy, the defense, of course, of the Panama Canal, which is the keystone of all our naval strategy, and perhaps the reinforcement of some other American nation which might be menaced. The army of a maritime power is just as much an M-day force as the navy. It must always be ready to give the navy the sort of support which the navy always requires from the land, and it must be ready to do so at an hour's notice.

We can no longer proceed on the comfortable theory that we we are going to have thirty or sixty days or six months before we will need an army, that is, unless we are going also to proceed on the theory that the army to be created is a mass

army to be sent across the seas to help somebody else fight a war.

We do need, of course, reserve forces. We must envisage the possibility that our Navy may be beaten. Nobody can have any assurance that he can create an instrument of war which cannot be defeated. The best we can do is to keep it at such a level of strength that it is not at all likely that it will be defeated. We have to take into account those changes in the European situation to which I referred, and which have been brought about by air power, because any change in the military situation of Europe affects the world at large and affects us very directly.

For two hundred years, Great Britain has been the principal sea power of the world. That is a situation which can no longer continue. The British Isles, the center and base of the British Empire, are open to a direct form of attack with which their Navy cannot deal. The British people are just coming to a realization of the change that this has brought about. The exposure to air attack of the great dockyards on which the British fleet relies, the necessity for Great Britain to create a great army to fight upon the continent alongside the French, and a great air force to defend herself—all these inevitably forecast the decline of the British sea power.

Just as, inevitably, must follow the rise of American sea power to that first position among the maritime nations of the world which Great Britain has so long occupied. From our point of view this is a position of tremendous advantage; because we are so placed as to be able to depend very largely upon the protection afforded us by our oceans so long as we control those oceans. But also we become sensitive to changes on the other side of those oceans, to changes in positions, such, for example, as the Azore Islands, or positions on the west coast of Africa which, in the hands of a potentially hostile power, might be disquieting to us.

This has always been the policy of the predominant sea power and must inevitably become ours. We must keep an enemy out of reach, unable to do us damage save by the defeat of our fleet. This was the policy of Great Britain, successfully pursued for two hundred years. It must be ours.

We can capitalize, if we will, on this magnificent position and these great advantages as compared with other Great Powers, or, of course, we can throw them away by foreign adventures. The difference in such a military policy and that which conceives of the sending of great expeditionary forces to other continents to engage in military adventures of unforseeable outcome is very great. A very considerable naval force and a small, highly trained, regular army, necessary to support it, including for both, of course, their necessary air components, can be created and kept up without the tremendous strain upon our industrial, commercial and labor resources which would be required by the sending of another A. E. F. to France, and the keeping up of the stream of shipping and supplies required there to maintain it.

If we are going to fight a totalitarian war on a totalitarian basis, then we must be prepared to accept totalitarian régimes. We must, in other words, begin the defense of democracy abroad (if it may be assumed to exist there) by destroying it at home. This does not seem to me to be a logical or sensible procedure. It does not seem to me to be in line with the destiny which is obviously marked out for the American nation. A glance at the map should be sufficient to convince any American of what the future holds. He sees his country placed between two great oceans, commanding the only short line of communications between them, possessed of a matchless industrial system, of natural resources which combined with those of the rest of the Americas makes this country far more self-sufficient in strategic raw materials than any other country of the world, possessed of a high standard of education and of living, and the only Great Power not exposed to direct attack either by land or through the air. If ever the signs and portents of the times, from the military point of view, indicated the rising star of a great nation, it is today, and the star is ours. While we remember that our star is, before all else, a star of the sea, the American people will be safe from attack and the American institutions which we all love will here, at any rate, be preserved from the fate which similar institutions, alas, are meeting in other lands.

Remarks by the Chairman

Chairman Morgan: I had reason to think from previous acquaintance with Major Eliot that we would have a logical and clear and acceptable presentation of a difficult subject. I am sure we are all very grateful to him.

Our next speaker is the editor of *Aviation* and he will deal with the subject of " Preparedness in the Air ".

Mr. Johnston was in the Officers' Training Camp in Plattsburg in 1918. He was a cadet pilot prior to the Armistice, stationed, however, in this country. Since then he has been graduated from Massachusetts Institute of Technology, and for the last eight years has been the editor of *Aviation* magazine. I take pleasure in introducing to you Mr. S. Paul Johnston.

AIR PREPAREDNESS

S. PAUL JOHNSTON
Editor of *Aviation*

IN his address Major Eliot has dealt largely with problems of general strategy and has touched somewhat on the strategy of air defense. He has also defined the difference between strategy and tactics, a distinction which is, I am sure, familiar to all of you. The matter with which I propose to deal is concerned more with industrial strategy than with tactics.

This is neither the time nor the place to deal with tactical considerations. That is a matter that concerns officers who actually command our fighting squadrons, and I shall touch the subject briefly and only to outline some of the tactical problems that have a direct bearing on procurement and training problems.

Over the last ten years the emphasis of our aviation development has been more on the commercial side than on the military. It is for that reason that our air transport has gone further than that of any other country in the world in speed, safety and economy. But recently the focus of attention has shifted and we are now facing a period of intensive military aviation development. Only last week were the first $50,000,000 of emergency appropriations made available for new purchases, and it seems likely that by mid-summer another $120,000,000 will be made available. What happens after that depends entirely on developments in world affairs in the next few weeks or months.

In the modern military airplane we have a relatively new weapon, one that is, comparatively speaking, as yet untried, but one that will have an increasingly important influence on the formation of national policies and on the preservation of our territorial and ideological integrity. Actually we are not yet certain of the exact rôle of aviation in modern warfare. The situation has changed materially since the close of the War

in 1918. At that time bombing machines were developing about 80 m. p. h. top speed, and pursuit aircraft could be counted on for a maximum of 120 m. p. h. Today specifications that are being written for bombing machines, both in this country and abroad, call for top speeds with large military loads of the order of 250 to 300 m. p. h., and pursuit specifications call for upwards of 400 m. p. h. Within the past week we have had reports from Germany indicating that certain experimental fighters have attained speeds of 460-odd m. p. h. or something like 20 m. p. h. faster than a world's speed record which was set not too long ago by a very special Italian racing seaplane.

With these changes in performance it is clear that many new tactical questions have arisen. What, for example, is the real mission of the bomber? Is it intended chiefly for use against civil and industrial centers, or against purely military objectives? What will be the new function of pursuit aviation? And how can we visualize " dog fights " in the manner of the last war between opposing pursuit pilots whose machines are flying at 400 m. p. h. and whose maneuverability is so limited by speed that the minimum turning radius might be as much as a mile?

Satisfactory answers to such questions have not come out of any military operations of the past few years, for in Ethiopia and in China operations were conducted against opponents with practically no retaliatory air strength, and what happened in Spain was little more than a laboratory experiment. Germany, Italy and Russia had no real interest in exposing their full aerial strength in Spain and looked upon their operations there as training for their military personnel and experimentation with new types of aircraft and armament. Actually the final answers to tactical questions of the sort outlined above must await the test of a major contest between opponents of practically equal air strength. Only then can the theories of Douhet or Golovine or Mitchell be proved or disproved.

For our present purposes then, let us examine briefly the elements that go into the overall air power of a modern state. Bear in mind, however, that we are speaking only of air power and not of total military power. Sometimes those of us who are intimately associated with aviation may be prone to overrate the importance of air power. It is a new weapon and a highly important one, but after all, it takes infantry forces on the ground to take and to hold objectives, and naval forces at sea to control the trade routes of the world, so men and ships are still the backbone of a nation's military strength. How far pressure may be brought to bear upon populations to change public opinion by the unrestricted application of air power is still a matter for speculation.

Certainly air power cannot be measured in terms of mere numbers of aircraft on Army and Navy rosters. One has only to consider the case of France in the last few years to make this point clear. For the ten years after the close of the War of 1914-1918, France was considered the ranking air power of the world. Even as recently as three or four years ago her air strength was considered between 4,000 to 5,000 military machines. Prior to and during the crisis of last fall it became very plain that French air strength was somewhat of a myth. Large numbers of the machines carried on the books were not only obsolete, but out of commission and actually unusable. In the meantime, due to unhappy social and economic conditions, the aircraft industry in France had been allowed to deteriorate to a point where it could no longer be counted upon to produce the requirements of the French air force, either in peace or in war. The condition became so bad last year (at the time of the crisis) that France was producing little more than one tenth the total number of aircraft coming out of German factories, and about one fourth of the number being produced at that time in England. We, of course, have benefited from this condition in the receipt of substantial orders from the French government for military aircraft. But in case of a general war, where our own factories would be needed for our own requirements, France might find herself in an extremely uncomfortable position.

Clearly, then, there are other elements in overall air strength. They may be boiled down to six general classifications, as follows: (1) number of aircraft, (2) quality of aircraft, (3) production rate, (4) production capacity, (5) personnel available, and (6) morale.

In estimating the number of aircraft, one must consider not only the machines in organized fighting squadrons, but also those in usable condition in reserve. A large reserve of first-

line machines is obviously desirable as it would form the "cushion", as it were, to take up the slack from the onset of a war until the time when the factories could be thrown into high gear to produce all the replacements necessary—of which, more presently.

Under quality we must consider not only the quality of the design of the machines with respect to the missions for which they are intended, but also their ease of maintenance, their structural efficiency, the proper usage of materials, and their performance. Such characteristics depend primarily on the results of research. It may even be said that victory or defeat in aerial warfare of the future is being measured out today in our aerodynamic, engine and structural laboratories. Going back further, the chemists and the metallurgists, and even the biologists are playing fundamental parts in strengthening our air defenses.

No one can question the importance of research in aviation, and yet it is a fact that several of the totalitarian countries of Europe are running far ahead of us in quantity, if not in quality, of aeronautic research. Germany, alone, has six to eight times the personnel engaged in research that we have. (Some observers put the disparity higher.) She has four or five large research centers where we have but one. Yet at this time Congress is holding up funds for a project that has been characterized by the heads of our Army and Navy air services as "emergency in character and essential to our national defense"—the expansion of our research facilities by the construction of another aeronautics laboratory at Sunnyvale, California. The present equipment at Langley Field is being worked to capacity—and a west coast site for new laboratories is desirable because of the high concentration of aircraft manufacturing in that area. It is to be hoped that the advices of our military and naval experts will be heeded, and the necessary money be appropriated at once to forge another vital link in our chain of defense.

Of all six elements mentioned, the two production factors are the most important. Many of our military authorities seem to agree that the rate of airplane replacement necessary in a modern war, fought at relatively short ranges (such as a war in western Europe), would be somewhere between 50 and 90 per cent of the airplanes *actually engaged, per month!* Which means, of course, that if you enter a war with an active force of 3,000 combat machines, you should be prepared to build replacements at a rate of 1,500 to close to 3,000 per month as long as the war lasts. The life expectancy of a military machine is, thus, relatively short.

There is a point here that may well bear some consideration, and that is: Why build military aircraft *too* well? It is obvious, of course, that we cannot consider scaling down in places which would militate against performance or would introduce undue hazards in operation, but it makes good sense to take into account the life expectancy of a military airplane under combat conditions and to build accordingly, rather than to require a type of construction normally insisted upon for commercial usage where thousands of hours are expected of a machine before its eventual retirement by obsolescence.

The importance of a large, smooth-running aircraft industry cannot be underestimated. The greatest asset a nation could possess would be large and well-equipped aircraft and engine factories, manned by trained workers, backed by adequate stocks of materials and necessary accessories. Such things, in the long run, are much more important than the mere numbers of fighting aircraft that could be mustered at the outbreak of hostilities.

The personnel and morale elements are equally important, and would certainly warrant considerably more time than we can put on them here. It is obvious that even the best airplanes are worth very little without competent pilots to fly them. It is obvious, also, that the replacement rate on pilot personnel will be almost the same as the replacement requirement for aircraft. The attrition among the ground forces, both in the field and in the factories, will not be as high as the attrition in the pilot personnel, but will undoubtedly be considerable, in view of the probabilities of mass bombardment against aerodromes and industrial centers. All of which means that that nation will hold a great advantage that has available the largest reservoir of trained and semi-trained people at its disposal.

The morale factor is less tangible, but is closely related to the personnel problem. In attempting to size up morale, it is difficult to compare the fighting morale of the organized air

forces or of the individual pilots of the several countries. The safest thing on that score is to assume that all are on a comparable basis (which may or may not be true). There is always a tendency to underrate one's opponents and to overrate one's own potentialities. This, however, can be a thoroughly dangerous procedure. The word "morale" as used here is intended to measure the industrial rather than the military morale. It is intended to reflect the personnel situation in the producing industries under war-time pressure and the likelihood of strikes and other interruptions in production due primarily to labor or social conditions. It seems probable, therefore, that the morale of the totalitarian states must be rated higher than the morale in the democracies, for, short of a complete social and economic breakdown within the totalitarian countries, the labor and the means of production are under better control than they are in the democracies.

A number of estimates have been made in the past few months on the relative strength of aerial armaments in Europe. They have been widely published, and I shall not repeat here. The importance of our relative standing in air power with that of European countries is, however, an open question, for our defense problem is very different from that of any country in Europe.

As a matter of fact, we are in a somewhat difficult position, for no one knows exactly what our defense problem really is. Comparatively speaking, the problem facing the major European powers is very simple, for, due to their geographical position and their intimate knowledge of what is going on across the borders of their potential enemies, they can visualize with accuracy not only the extent of potential air attacks, but also the probable direction from which such attacks may be made.

Our problem is certainly not as simple. For example, if it is decided that our best defensive move is to go to the aid of the other democracies by participating in a war in Europe, then we must make our plans to put in the field large quantities of airplanes that are suitable for operations in masses at relatively short ranges. In other words, we must build types that are comparable to the types that are being built in Europe today. If, however, our foreign policy directs that we confine our attention to the western hemisphere and to the preservation of the Monroe Doctrine, then our flying operations would be very different in character, and would require radically different types of machines.

In spite of a certain amount of newspaper talk, it will be some time before aviation will advance technically to the point where direct air attack against America from the continents of Europe or of Asia will be possible. With present knowledge of design and operation, it is quite possible for trans-oceanic commercial flights to be made with safety and with certainty. But even with the most advanced military airplanes we cannot visualize flights to America and return, non-stop (or even one way) carrying any effective military loads. It is quite possible that a few sporadic raids of such character might conceivably reach our coasts, but certainly their military significance would be absolutely negligible.

Aerial attacks against coastal cities from aircraft carriers are of greater probability, but here again their military effectiveness would be very slight. It is apparent that the planes which operate from aircraft carriers must necessarily be of small size and of limited number, and while certain exposed cities might suffer some damage from "hit-and-run" raids conducted from carriers at sea, yet the effect of such raids would be only irritating rather than conclusive as far as any of our military or industrial operations might be concerned. And besides, an aircraft carrier at sea is quite vulnerable to retaliatory attack from shore-based aircraft, although the location of the carrier might be somewhat difficult to determine. For such purposes it is obvious that we would have to build a type of airplane capable of long-range scouting at sea, and capable of carrying effective defensive armament and at the same time an offensive complement of heavy bombs.

The most potentially dangerous threat against our security from aerial attack lies in the possibility of foreign countries establishing air bases on the American continents. Our air defense problem then will resolve itself to operations to prevent the establishment of such bases, or to destroy such bases as might in some fashion be laid down without our knowledge (as unlikely as that contingency might be). For such operations we must again provide land or sea aircraft capable of operating

with effective military loads over extremely large ranges. We are thus on the horns of a dilemma, but fortunately both geographical position and time are on our side. It is obvious that the surrounding oceans afford us ample protection against surprise attack from any direction at present. Even with technical advance at an extremely rapid rate, it will be many years before we can look for danger from such sources. And with present pressure of local affairs in Europe, it seems unlikely that any foreign nation will have time or energy to expend on extensive base-laying expeditions to the Americas in the near future.

The problem of providing bases for offensive bombing operations on any scale that might be of a determining character against us is no easy one. It takes a great deal more than a large vacant lot to provide an adequate base for large-scale bombing operations. There are serious problems of supply, of maintenance, and of personnel to be considered, all of which make it very unlikely that adequate bases for military operations could be laid down anywhere without long advance warning. Even commercial airports that may be already set up and operating in certain South American countries could not be transformed for military uses overnight and secretly.

Time, therefore, is our greatest present asset, but we cannot afford to waste it. World conditions are changing so rapidly and technique is advancing so rapidly, that we must take advantage of what breathing space we have to make a very realistic approach to our defense problem, and to attempt to find a rational solution.

As I see it, that is exactly what the government is attempting to do. Several months ago there was a danger that we might be rushed into an air expansion program far beyond our immediate needs, and one that might have handicapped us seriously in the future by the accumulation of a large quantity of aircraft that would soon become obsolete.

But today, the danger of such a move seems past. Our military and naval experts have made careful surveys of our service and manufacturing situations and have developed plans that seem adequate for our immediate needs, and a program that provides for expansion without dangerous mushrooming, one that will insure us a nucleus of adequately equipped plants, and a large reservoir of trained personnel which may be quickly and efficiently expanded if a real emergency develops.

It is in this respect that the totalitarian countries of Europe have at least two or three years' advantage in military aviation. They pictured themselves in an emergency situation four or five years ago and acted accordingly. They put their entire aviation and other industries under virtual dictatorship and have succeeded in a relatively short time in building up the most powerful air forces in the world, backed up by a large and efficient system of plane and engine production, with controlled labor and controlled services of supply.

The democracies of Europe, characteristically, fumbled about with "shadow schemes" and nationalized aircraft industries—they were unwilling to put themselves on emergency status until the emergency was practically upon them. Only in the past few months have they been making the readjustment called for by the seriousness of the situation—and it was almost too late.

Here, again, time is in our favor. We have opportunity now to take advantage of the lessons learned in Europe in the past few years. We can build the greatest aviation industry in the world—for peace or for war—but we will do it by coöperation and coördination under a system of privately owned industry, rather than under the compulsion of dictatorship—for that is the American way of doing things.

Remarks by the Chairman

Chairman Morgan: Thank you, Mr. Johnston, for your informing and interesting paper.

Every American loves the Navy. As boys we were brought up to know the names of the distinguished admirals of our fleet. We all knew John Paul Jones — almost by sight, I should say — Stephen Decatur, Porter, Farragut, Dewey, Samson, Schley. More recently, we know Admiral Standley, who is not only Admiral of the Fleet, but Admiral of the Navy; he was a member of the United States general delegation to the Disarmament Conference in London in 1934.

Admiral, in inviting you to come up here and talk to us, I choose between the words of two of your predecessors. I might say, "Fire when ready, Gridley", or I might say, "Damn the torpedoes, go ahead!"

THE STRATEGY OF SEA POWER

WILLIAM HARRISON STANDLEY

Admiral, U. S. Navy, retired, Former Chief of Naval Operations
Member U. S. Delegation to General Disarmament Conference, London, 1934

It is indeed a great privilege to be permitted to take part in this discussion of "America's preparedness to preserve democracy." The United States of America is a democracy with a representative form of government where sovereignty rests with the people and where the will of the people expressed by majorities governs as to both domestic and foreign relations.

Probably at no time in the history of our country has the understanding of problems of government and of foreign relations been of greater importance to the continuance of the principles of democracy than it is today, and yet the discussions which have been going on in and out of the halls of Congress, in the press and on the radio, would indicate the greatest confusion of thought in the minds of our people on these vital issues, and I welcome the opportunity to lend a helping hand to this Academy of Political Science in its efforts to clarify these issues and thus promote disinterested, informed public opinion.

My subject today is "The Strategy of Sea Power" and I have been allotted twenty minutes for the discussion.

There is much confusion of thought and many faulty conclusions because of the misconception on the part of the public as to the term "sea power". Very often this term is used when only naval strength is meant. I have no doubt that many of this audience here today expect me, in discussing sea power, to confine my remarks largely to the building, organization, administration and operation of our combatant fleet; whereas the fleet, or naval strength, is only one of the elements of sea power.

On the other hand, sea power, in its true aspect, covers such a wide field and overlaps so many other elements of national interests and welfare as to make it difficult for the seeker of truth to be other than confused. It would seem then, and particularly in view of the time limit, that the greatest contribution I can make to the purpose of this discussion—clear thinking by disinterested public opinion—is so to delineate my subject as to enable the student to consider such questions as sea power, policy, national interests and their various strategies in their proper place, meaning and relation, each with the other.

The term "strategy" has a very general application: we speak of football strategy, military strategy, strategy in statecraft. In fact, strategy in its general application may be defined as the science of providing, combining and employing "means" with which to accomplish a specified "end", so the first step in my discussion is to determine the specified "end" —the purpose or objective, as it were—of strategy used in combination with sea power; and this leads us at once to the analysis of sea power.

One writer has defined sea power as: "The power to use the sea and—its corollary—the power to deny the use of the sea to the enemy in time of war." Another writer says: "Sea power is the expressed ability of a people to conduct and to control both mercantile and military transportation by sea more or less extensively both in war and in peace."

These definitions would seem to state the end in view, the purpose of sea power, rather than to give, except by inference, its constituents. In both cases it is clear that sea power is consequent upon the desire and in some cases the necessity for interchange of products from diverse lands.

This desire for overseas trade led to the discovery of America, and the germ of sea power, in the necessity for sea communication with the mother country, was brought to this country by these early settlers.

This exchange of produce between countries calls into being the necessary carrying tonnage or "shipping power" and leads to overseas interests; the protection and sustaining of these—policing the seas in peace, and controlling the use of vital sea areas in war—require naval power.

Thus maritime trade is the parent of shipping power; shipping power begets naval power; and the twain are the maritime constituents of sea power. Other constituents of sea power, however, are not so obvious even to the expert.

In his *Influence of Sea Power upon History, 1660-1783*, written some fifty years ago, Admiral Mahan stated:

France, admirably situated for the possession of sea power, received a definite policy for the guidance of her government from two great rulers, Henry IV. and Richelieu. . . . Richelieu left what he calls his political will, in which he pointed out the opportunities of France for achieving sea power, based upon her position and resources. . . . That part of the administration which dealt with trade, manufacture, shipping, and colonies, was given [1661] to a man of great practical genius, Colbert, who had served with Richelieu and had drunk in fully his ideas and policy. . . .

To enter into the details of Colbert's action is beyond our purpose. It is enough to note the chief part played by the government in building up the sea power of the State, and that this very great man looked not to any one of the bases on which it rests to the exclusion of the others, but embraced them all in his wise and provident administration. Agriculture, which increases the products of the earth, and manufactures, which multiply the products of man's industry; internal trade routes and regulations by which the exchange of products from the interior to the exterior is made easier; shipping and customs regulations tending to throw the carrying trade into French hands, and so to encourage the building of French shipping, by which the home and colonial products should be carried back and forth; colonial administration and development, by which a far-off market might be continually growing up to be monopolized by the home trade; treaties with foreign States favoring French trade, and imposts on foreign ships and products tending to break down that of rival nations,—all these means, embracing countless details, were employed to build up for France (1) Production; (2) Shipping; (3) Colonies and Markets,—in a word, sea power. . . .

In these three things—production, with the necessity of exchanging products, shipping, whereby the exchange is carried on, and colonies, which facilitate and enlarge the operations of shipping and tend to protect it by multiplying points of safety—is to be found the key to much of the history, as well as of the policy, of nations bordering upon the sea. The policy has varied both with the spirit of the age and with the character and clear-sightedness of the rulers; but the history of the seaboard nations has been less determined by the shrewdness and foresight of governments than by conditions of position, extent, configuration, number and character of their people,—by what are called, in a word, natural conditions. It must however be admitted, and will be seen, that the wise or unwise action of individual men has at certain periods had a great modifying influence upon the growth of sea power in the broad sense, which includes not only the military strength afloat . . . but also the peaceful commerce and shipping from which alone a military fleet naturally and healthfully springs, and on which it securely rests.

The foregoing has been briefed by Mahan as follows:

The principal conditions affecting the sea power of nations may be enumerated as follows: I. Geographic Position. II. Physical Conformation, including, as connected therewith, natural production and climate.

> III. Extent of Territory. IV. Number of Population. V. Character of the People. VI. Character of the Government, including therein the national institutions.

Here we have summed up in one paragraph—written some fifty years ago and based on events back to 1660—the whole philosophy of sea power; and world events since Mahan penned these almost prophetic words, even to this very moment, have proved how clearly this sailor thought and wrote and how true to form has run the history of our own country.

Let us repeat that the strength and importance of a country is not gauged by its natural conditions and inherent wealth in raw material, but by a combination of these and what its people do with them. Termed, if you will, " national strategy ", this has been defined by military writers as: " The provision, preparation and use of diplomacy and of the nation's armed forces (army and navy) in peace and in war to gain the purposes of national policy."

Now let us follow this up with the definition of policy, which is: " The system of measures or the line of conduct which a ruler, minister, government or party adopts and pursues as best for the interests of a country as regards its foreign and domestic affairs."

If we examine the previous paragraphs in the light of this definition of policy, we will see that policy and " The Strategy of Sea Power " and the history of a country are almost synonymous, the difference appearing only under the most detailed analysis.

This difference, however, is obvious in the above definition of national strategy, that is, " The provision, preparation and use of diplomacy and of the nation's armed forces (army and navy) in peace and in war to gain the purposes of national policy."

Thus we see that diplomacy, military strength and naval power are co-partner instrumentalities to be used both in peace and in war to initiate and mutually support measures out of which grow policies which have for their purpose the best interests of the country as regards foreign and domestic affairs.

Sounds rather involved, does it not? And it justifies a statement made by Dr. Stanley K. Hornbeck in a lecture delivered at the Army War College in January to the effect that:

> In regard to *no* country is it possible to say at a given moment exactly and completely what are its policies. In regard to *few* countries would it be possible to say in advance by just what means and instruments its policies will be carried out. And in regard to *all* countries it is necessary to realize that formulation and execution of policies in regard to foreign relations take place in the light of circumstances and developments in and among other countries and that both are greatly influenced and affected by some factors over which those who are responsible for them have little or no control.

Is it any wonder then that seekers for knowledge of our national institutions and its policies are confused by the many strategies involved? But again I quote from Dr. Hornbeck:

> The foreign policy of the United States need be no mystery and no puzzle to anyone who will sufficiently familiarize himself on the one hand with the history of the United States and its people, and on the other hand with the situations which confront this country in its relations with other countries in a world which is constantly growing smaller and from which no country can withdraw.

And so, if the student would think and speak and write clearly about the national policy concerning such questions as preparedness, sea power, military strength, interest and part in world affairs, neutrality laws and allied subjects, he must thoroughly inform himself concerning each of them and their relation to each other.

Let us revert now to my subject, " The Strategy of Sea Power ", and restate it in the light of the preceding discussion. My subject would now read: " The providing, combining and employing of natural conditions—geographic position, physical conformation (including as connected therewith natural production and climate), extent of territory, number of population, character of people, and character of government, including therein the national institutions—in order that the nation may conduct and control both mercantile and military transportation by sea more or less extensively both in war and in peace."

As thus stated, the impossibility of getting anywhere in a discussion of the subject in twenty minutes is apparent.

We have noted, however, that naval power, diplomacy and military power are co-partners in the business of shaping national policies, but in this business of shaping national policies " timing " is just as important as it is in golf, in dancing, in mechanics, in science or in any other activity involving movement—such as the passage of time.

We can never be sure just when these various elements will be needed. We know that in peace time diplomacy is and should be at the helm, but we cannot know just when sea power or military strength may be needed to give point to diplomacy. Our history is full of incidents—such as the sending of our battleships around the world in 1908, the Venezuela Incident, our trek into Mexico after Villa, the landing of small forces throughout the world with resulting minor conflicts, and even the recent change of orders to the Battle Fleet—where sea power or military strength has been used in peace time to support our diplomatic representations.

When war comes, naturally the military and naval organizations will assume the leading rôle, but statesmen cannot and do not take their hands from the situation for an instant. For purposes of treaties we may agree to renounce war as an instrument of policy, but when war comes we cannot escape the fact that diplomacy has failed and that the statesmen have had to resort to force to gain the ends of policy. Theirs is the responsibility of putting us into war and theirs is the responsibility of saying when the desired objectives have been attained, and when war should end.

Efficiency and adequacy in diplomacy and military and naval strength alike cannot be improvised on short notice. To be effective they must be adequate, efficient and ready when needed, and it is the responsibility of the statesmen, as well as the military and naval men, to provide and prepare the armed forces for use when needed.

Various writers state that the diplomatic efforts under the Articles of Confederation were a sorry spectacle. To the lack of a navy was ascribed the reason for the failure of American statesmen to hold Great Britain to the terms of the peace treaty of 1783, to force Spain to open the lower reaches of the Mississippi River, and to secure access on more favorable terms to the home and colonial markets of the Great Powers.

> Without a navy, Congress could neither punish nor overawe the North African Barbary Powers, whose piratical cruisers were plundering American merchant shipping in the Mediterranean. In the event of another war among the European Powers, regarded as imminent during these troubled years, it seemed highly doubtful if the Continental Congress would be able, without any tangible symbol of national power upon the sea, either to forestall belligerent aggression against neutral American shipping, or even to prevent the United States from being drawn into the conflict. "A nation despicable by its weakness," it was contended, "forfeits even the privilege of being neutral." *

It is interesting to note, however, that while the early colonials neglected both diplomacy and naval strength there was one element of sea power, that is, shipping, which they did not neglect.

As I stated, it was the mother country's sea power which brought these early settlers to our shores and sustained them there in the beginning. But they came with the traditions of the sea inherent in a people who, for hundreds of years, had looked for security and protection to sea power. They found here all the natural conditions for sea power and the maritime interests; foreign trade, inter-colonial commerce, whaling and the fisheries engaged a large portion of the capital and inhabitants. Under these conditions shipping flourished and grew apace with the growth of wealth and interest in world affairs. In 1775 the American Colonies operated over a third of all British shipping, and in 1855 almost half of all the shipping of English-speaking people engaged in deep sea trade was American-owned and operated. It was during this period that the American clipper surpassed the world in speed. Then the eyes of our people turned away from the sea, when the western boom of railroad building and other inland enterprises drew the support of our national government away from foreign trade, shipping and the Navy.

The strategic timing for shipping became poor, and when the Spanish-American War broke out we had to depend upon foreign merchant bottoms to service our fleet and overseas military operations. However, this was not particularly embarrassing because the rest of the world was at peace and there was abundance of shipping to be had at a price.

The same thing happened in 1908 when President Theodore Roosevelt, as a diplomatic gesture, sent the Battle Fleet around the world and we were again forced to use foreign bottoms to service the fleet.

* The last sentence is a statement of Alexander Hamilton, quoted in *The Rise of American Naval Power*, by Harold and Margaret Sprout.

Conditions were not so happy, however, when the World War overtook us; when the Allied shipping was withdrawn millions of tons of produce rotted in freight cars on tracks in the Jersey marshes and millions of bales of cotton and other produce were left in the field because we had no merchant tonnage of our own to handle it. When we finally came into the War we had to use foreign bottoms to transport our troops overseas and maintain them there. When President Wilson found he could remain neutral only by waging neutrality, he lacked the sea power with which to wage it.

We Americans are characteristically disposed to neglect the lessons of history and today we find ourselves, one of the richest and most ambitious nations in the world, lacking in the maritime elements of sea power and in certain essentials for effective military industrial mobilization.

World events, however, have shocked us into action. We are now embarked upon a program which has for its purpose the building up of our Navy, our air forces and our merchant marine and plans for military industrial mobilization.

When this program is completed we will have an effective triumvirate team of diplomacy, military power and naval power, the proper functioning of which will give us the most effective support of our national policies, the maximum of security to our national interests and institutions and guarantee the integrity of our neutrality on all proper occasions.

Such a state of preparedness will be the surest guarantor of America's democracy and thus, in my opinion, of the peace of the world.

Remarks by the Chairman

Chairman Morgan: Thank you for that most informative address.

I know of no one better able than the next speaker to take an abstruse, difficult financial subject and make it clear, crisp and interesting. I present Dr. John H. Williams, Vice President of the Federal Reserve Bank of New York, and, in his odd moments, Dean of the Graduate School of Public Administration at Harvard University.

FISCAL POLICY AND PREPAREDNESS

JOHN H. WILLIAMS
Dean of the Graduate School of Public Administration, Harvard University
Vice President of the Federal Reserve Bank of New York

THE fiscal principles of preparedness are similar to those of war finance itself, but the problems presented may be even more difficult. A war, even a long war, is relatively short whereas preparation for war may be indefinitely continued. During war, moreover, we are willing to subordinate all ordinary considerations of living, but during preparedness there is much more question whether this is or should be the case.

We are all aware of the tremendous cost of modern war. In fact prior to the World War, it was frequently said that the cost would prohibit a long war. How expensive war has become is seen by comparison of nineteenth-century wars with the World War. The figures given by Bogart are 3 billion dollars for the Napoleonic War, 7 billion for our Civil War, 3.2 billion for the Franco-Prussian War and 186 billion for the World War.[1] Yet the financial cost was not the decisive factor in determining the length or the outcome of the World War.

Compared with the cost of war the yearly cost of preparedness is of course much less, but as I have said it may have to be borne for a much longer period. As to how expensive modern preparedness may be we have eloquent testimony in the new British budget. In the fiscal year ending next March 31, the British budget will exceed 6 billion dollars and of that amount about 3 billion will be spent for armament. Three billion is roughly 10 per cent of the entire British national income, and this burden falls upon a country whose tax revenue at the present time is almost 25 per cent of its national income.

[1] *War Costs and Their Financing,* page 85. The Napoleonic War figure represents only the increase in the debt of Great Britain and France.

No attempt is made in the British budget message to forecast what it would cost to place the whole British military system upon a conscription basis. In the face of such a burden as this, and the German and Italian burden in recent years must have been relatively greater, it is no wonder that the question now being asked is whether nations can long stand the cost of modern preparedness for war, especially when it is recalled that these expenditures come so soon after the termination of the Great War and fall upon nations whose public debt, revenue and expenditures have been greatly increased by that War and the ensuing economic maladjustments.[2]

At bottom, these are not so much financial problems as economic problems. Finance is but a means to an end. The end is to make available to government the resources and the man power that it needs to prepare for and to fight a war. In a non-monetary society we could imagine the government's calling upon every individual to deliver in kind and according to his ability some portion of his wealth and income. In a monetary society this transfer of men and resources from peace to war-time uses is attempted through public finance and the banking system. Fundamentally, the strength of a nation in war, or in preparation for war, is indicated by the amount of resources which can be thus transferred without undermining the efficiency and morale of the community. How much of our real wealth and income can we afford to transfer, year after year, from the ordinary business of living to the support of a military machine which in an economic sense, of course, is unproductive?

Essentially, the problem is how to achieve this transfer without setting in motion the destructive processes of inflation. This is likely to call for much more than the exercise of sound methods of finance. It requires, for example, the shifting of existing factors of production and of new investment into war industries without causing acute scarcities and large price increases in other goods. This requires a high mobility and adaptability of productive factors and an efficient control over the demand for individual goods and services. If automobile companies are required to make trucks instead of pleasure cars,

[2] In some cases, notably that of Germany, the debt burden was erased by post-war inflation.

will the demand for the latter diminish? If steel, cement or other building materials are shifted into armament, will there be a corresponding decline in non-military construction? To some extent such disturbances can be avoided if there is idle productive capacity, or if productive capacity can be increased notwithstanding the transfer of men and materials to military uses, but if the preparedness program is large and long continued and there is severe pressure on resources, all the phenomena of inflation, or at least of "bottle-necks" which are very similar, can appear however soundly conceived the financial plan may be. If inflation should come in England, as a result of her extraordinary preparedness efforts, it would probably be by reason of the physical and economic difficulties involved in such a shifting of the economy rather than because of any defects in her financial plan. Mr. Anthony Eden was doubtless thinking of these difficulties when he said on his recent visit that if England is to prepare effectively she may have to take a leaf from Hitler's book and subject herself to a measure of totalitarian control. Here is another comparison between war and preparedness which is unfavorable to the latter. We might go totalitarian in a war for a temporary period; serious as that would be, it is less serious than to contemplate such a development in peace time with a very indefinite prospect of reversion to our former state.

The fact that I have emphasized the economic rather than the financial aspects of preparedness does not mean that there are not better and worse financial policies and that the methods chosen might not have a decisive effect upon the outcome. The methods of financing war and war preparation are taxes, loans and monetary expansion. The first two, within limits, are not inflationary. The third may easily become so. The danger in borrowing is that, unless carefully safeguarded, it leads more readily than taxation to monetary inflation. I have not time to deal with these financial methods in detail. Most students agree that taxation is preferable but recognize that it has serious limitations. Its purpose in this case would be to effect a transfer of the community's money income to military expenditure, which should be accompanied by a corresponding transfer of real income. In so far as it falls on consumption, taxation obviously facilitates such a transfer; if it falls on saving for investment, it facilitates transfer of new productive equipment to war industries. If it falls on idle saving or on excess war profits, little or no economic loss is involved and there may even be some gain. But there are serious limits upon the extent to which taxation can be increased and upon the speed at which the increase can be carried out, even though we can perhaps never know just where at any given time these limits are. Consumption must not be reduced to the point of impairing labor morale and efficiency; investment must not be impaired to the point of preventing essential capital replacement. This is one more respect in which the preparedness problem may be more serious than war itself. In a war, for a limited period, we might deliberately permit some impairment of our peace-time capital equipment for the sake of a more intensive military effort, but such undermining of capital through inadequate investment or replacement during a long period of preparedness would result in a general deterioration of the economy and would sap the nation's ability to fight a war.

The cumbersomeness and slowness of the process of raising the needed revenue by taxation, the inequities as between individuals and classes, and the disturbances to production and capital maintenance which arise whenever large and sudden changes are made in the tax system inevitably compel resort to borrowing. No major war has ever been financed mainly by taxation, and it seems improbable that any major preparedness program will be, particularly now that taxation in all the leading countries has become so large a fraction of the national income. Borrowing is likewise intended to reach savings and to do so more surely and promptly than taxation. But it also leads more readily to monetary expansion which may become inflationary. The banks themselves will be large security buyers, and if the scale of borrowing is extensive, we are likely to find the community borrowing from the banks in order to purchase government securities. In both cases, if the banks have excess reserves or are willing to borrow reserves from the central bank, the process of lending to government will not merely absorb savings but will involve the creation of new money. How far this process can be carried we saw even in this country during the World War, and we have seen it again in one aspect, bank buying of government securities,

during the past decade, as a phenomenon of deficit financing. In both cases there was an extraordinary increase in deposits, unrivaled by any other monetary expansion in our national history.

One cannot say definitely whether the next war will be more inflationary than the last, but it seems probable in view of the present size of national debts and tax burdens. A more pressing question is whether preparedness on its present scale may not precipitate inflation. I have already referred to the magnitude of the British problem. I have very little reliable knowledge of Germany, but the program recently announced, following Schacht's departure from the scene, whereby the government is to pay for 40 per cent of armament costs with non-interest-bearing tax certificates, which will be transferable as money, and which the government will later accept in lieu of taxes, the consequent reduction in taxes to be offset by an increase in the rates of income tax, would sound very much, if it were tried here, like an admission that the government had reached the end of its ability either to tax current income or to borrow through the ordinary mechanism of the capital market.

In this paper, I have not been thinking primarily of our own problems of preparedness, which are less acute than those of others, but I want to conclude with some reference to our situation. If the world is entering upon a new race in armaments, we are likely to participate in it, and indeed have already begun to do so. The cost will probably be less for us, both absolutely and relative to our national income, than for the other leading countries. But it will come on top of ten consecutive years of budgetary deficits. If we defray the cost by taxation, that will be on top of revenue (federal, state and local) which is now almost a fifth of our national income, and will intensify the defects of our tax structure now so generally recognized. If, as seems more probable, we borrow, the new debt will be on top of a federal debt which is now approaching double what it was at the end of the last war.[8]

[8] On October 31, 1918, just prior to the Armistice, the interest-bearing debt of the federal government amounted to $18,335,000,000. The peak was reached on August 31, 1919, at $26,349,000,000. On April 30 of this year the interest-bearing debt amounted to $39,525,000,000 and the debt at the end

We need not exaggerate these difficulties. I have no doubt of our ability to bear substantially more debt. Per capita our debt burden is about half that of England. Since our depression deficits began there have been recurring waves of fear, and possibly sometimes of hope, that they would bring on inflation. That fear was probably greatest in 1934 and 1935, and has been lessened by continuing experience of deficits which have not resulted in inflation. The nearest actual approach was in the conditions that developed in the fall and winter of 1936-7. I have felt that the fear of inflation was exaggerated, and based mainly upon imperfect analogies with European war and post-war conditions. Inflation has sometimes occurred through a breakdown of the public credit, but with money and capital markets as broad as ours, a well-developed central banking system and a huge volume of excess reserves, the growth of our public debt would undoubtedly have to go much farther than it has gone before there was serious danger of inflation arising from this source. What we have witnessed indeed has been just the opposite, a progressive fall in the yield on government securities accompanied by a large increase in the volume of securities outstanding.

As suggested earlier, the danger of inflation is greatest when production and employment are at a high level and there is strain upon a country's productive resources; at such a time, moreover, a country is likely to have an adverse balance of international payments, and this external strain may precipitate the inflationary process through currency depreciation. It was in these respects that I felt the falseness of the comparisons with war and post-war European inflation when applied to a country during a depression, with large amounts of unemployed productive factors. We had no occasion to fear the imminence of inflation until we had experienced a more complete recovery, for which we are still waiting.

There is one further way in which inflation might develop, but I can do no more than mention it here since it goes somewhat beyond my subject. It is possible that some fundamental change of political or economic outlook, resulting in a great wave of confidence in the future, might lead to economic expectations, and to speculative activities based thereon, which with our present large supply of money and excess reserves, combined perhaps with some feeling of caution against premature restraint after so long a period of sub-normal business, might set in motion an unduly rapid expansion. But it does not seem probable that such a movement would reach the dimensions of a runaway inflation before effective measures were taken to counteract it.

of June 1940 was estimated in the President's last annual budget message at approximately $44,000,000,000.

The fact that we have not yet had a satisfactory recovery has raised the question whether a large preparedness program at this time might not be desirable as a recovery measure. It is pointed out that the British armament program has helped England to avoid the decline which would otherwise have occurred as her building activity began to slacken. When a country, such as ours at present, has idle men and idle capital in abundance it has little occasion to worry about the problems of undue strain upon resources to which I referred earlier. The immediate problem is to put men and resources back to work, and this, it is argued, could be done more effectively by an armament program, which affects directly the heavy industries, than by relief and other forms of spending which affect directly consumption, with an uncertain prospect as to how effectively this stimulus can be communicated to the capital goods industries. And even the increase in the public debt might not be so great as might be supposed, since we would be substituting war preparedness finance for relief finance.

I have no doubt that a substantial increase in expenditures for armament would increase production and employment, for the time being. But what we really need, it seems to me, is some evidence that we are still capable of self-sustaining economic activity at a reasonably high level of real income and employment. There are today various schools of thought that rationalize our experience of long continued deficits in terms which suggest they may last much longer or should be even larger. Different writers emphasize different things: chronic over-saving, a contracting economy with insufficient outlets for investment, a growing rigidity of our economic system. Pessimistic forebodings of this general nature have been characteristic of every major depression of the past hundred years, and no one could in the past, or can now, say how correct they might prove to be. If they are correct, and public spending is required for an indefinite period to provide employment, the distinction between preparedness spending and relief spending is secondary, with the advantage probably lying with the former. I have, however, been dubious about the correctness of these views, though I cannot take the time today to develop my own position;[4] and to the extent such views might prove correct I would favor some other type of public spending, more analogous in nature to private investment than either of these. It is difficult to see how any type of public spending which does not produce real income can be an answer to a *secular* tendency toward economic contraction. In theory, at least, the case for *cyclical* spending of this character is stronger, because it rests upon the assumption that the economy is, in a long-run sense, self-sustaining and that what is needed is a temporary stimulus to set in motion the cumulative processes of private spending. For such a purpose the public spending need not itself produce real income, if it leads to such production in the economy at large. But I recognize that the questions raised by this reference to different kinds of spending are too complex for treatment in this paper.

Our difficulty today is that despite ten years of deficits we have not achieved full recovery. Whether we view our problem as cyclical or secular this record is discouraging. The essential issue today is not between fiscal orthodoxy and compensatory spending, of whatever type. Surely no one who favored deficits on theoretical grounds contemplated ten years ago that by July 1940 we would still have a deficit, that the expenditures of this year and next would be the highest of the entire decade, exceeding even those of the year (1936) in which the soldiers' bonus was paid, or that for the entire decade the yearly revenue would average only 60 per cent of the expenditures, and this in spite of the fact that the revenue had been tripled since the bottom of the depression, with new taxes imposed and tax rates raised, and is now about 50 per cent greater than in 1929 though the national income is about 25 per cent less. No amount of reference to our ability to bear debt, or to achieve an eventual automatic balancing of the

[4] See my paper, "The Formation and Use of Capital"—PROCEEDINGS OF THE ACADEMY OF POLITICAL SCIENCE, March 25, 1938.

budget through recovery of national income to a "normal" level actually achieved only in the late twenties, adequately disposes of these facts.

There is an inescapable human tendency to rationalize experience, and it is not surprising, under such conditions as those of the past decade, that we have found ourselves progressively shifting our ground. When the deficits first began they were clearly not the product of any conscious policy, but simply of the great decline of revenue during the depression. The expenditures of the Reconstruction Finance Corporation—begun in 1932, severely criticized by the Democratic Party in the campaign of that year, which was run on the issue of economy in government, but subsequently continued—were not conceived in terms of any theory of compensatory spending, and even the relief expenditures were not regarded, in their inception, as primarily a recovery measure. For at least a year after March 1933, the main emphasis for recovery was on monetary measures, especially the devaluation of the dollar, and upon the N.R.A. program which was later abandoned. But as the deficits continued, despite substantial increases in revenue, and as interest in other recovery measures waned, the "pump-priming" theory came increasingly into vogue. This theory, in the earlier versions, implied that the net public spending would be comparatively small, or at any rate would last a comparatively short time; and it contemplated not only deficits in depression but surpluses in prosperity, with an even balance for the business cycle as a whole. Now, with a new depression and a new spending program, less is heard of "pump-priming" in the more limited sense, and practically nothing is heard of surpluses, now that expenditures have mounted to more than double their level in the late twenties. The proponents of public spending now find themselves defending the propositions that the budget can eventually be balanced, if the national income recovers to the highest level it has ever previously attained, and that any attempt to balance the budget before that level is reached would do more harm than good.

I am not opposed to compensatory fiscal policy. Under the conditions created by the great depression I do not see how budgetary deficits could have been avoided. But one of the chief lessons which I draw from our experience is that such a policy, to be successful, must have reasonably definite limits of time and magnitude or it will set in motion forces which defeat it. Whether such a policy can be operated effectively in a democracy is a grave unanswered question. Our experiences of the past decade create a strong presumption that we have gradually allowed ourselves to place undue reliance upon deficits as an instrument of recovery and that it has had in practice the effect of diverting our attention from specific problems and conditions retarding investment, in the comfortable assurance that it is possible, to use the popular phrase, to "spend our way out of depression."

What we need most today is not a larger armament program, but a positive program of encouragement to private investment and enterprise. The fact that we may find ourselves in future years forced into increased expenditure for preparedness is an added reason for such a program. I cannot enter upon a detailed discussion of current problems, but two suggestions seem especially pertinent to our topic. The first is the need of thorough study and revision of our federal system of taxation and of its relation to state and local taxation. The current insistence upon removal of tax deterrents to enterprise and investment has an important kernel of truth, though the effects to be expected from a removal of such deterrents are probably exaggerated. Broadly speaking, our tax system seems to me to rest too heavily upon consumption and also upon large incomes available for investment, and too lightly upon the middle incomes. If in the future we have to increase our expenditures for preparedness further, there is probably no better way of preparing ourselves for such expenditures than to put our tax system in shape to bear as large a part of the burden as possible without impairing productive efficiency. The other suggestion, which is also in the interest of preparation for preparedness, is that our current fiscal policy should, without introducing sudden or drastic changes, nevertheless give clear evidence that we expect within a reasonable period to achieve a balanced budget, without relying entirely upon an automatic balancing when full recovery is achieved, and that we now have some confidence that recovery can be attained by other means than deficits.

PART III

DEMOCRACY AND THE ISSUE OF PREPAREDNESS

INTRODUCTION *

W. RANDOLPH BURGESS, *Presiding*
Vice-Chairman of the Board, National City Bank of New York
President of The Academy of Political Science

SINCE I have on one side of me a former aide of Secretary Baker, and on the other side a former aide of General Tasker Bliss, it seems to me appropriate to begin the proceedings tonight by relating an anecdote of a conversation between Mr. Baker and General Bliss. It seems to me particularly appropriate to tell it before they have a chance to tell it themselves. (Laughter)

In the summer of 1918, Secretary Baker was in France and visiting with General Bliss, who was at that time a member of the Supreme War Council at Versailles. The Secretary turned to General Bliss, who was a very wise old man, and said, "General, how long do you think the war will last?" General Bliss thought a minute and said, "About thirty years."

Secretary Baker looked surprised, and the General went on, "Oh, I don't mean the present engagement, but I mean that after this particular engagement is terminated, the terms of peace will be so difficult and there will be so much bitterness that there will be no lasting peace for thirty years."

That was nearly twenty-one years ago, and I think that the General is still right. Here we are, twenty-one years after the world was made safe for democracy, and the Academy is again holding a meeting in which preparedness for war is the major topic. We have had meetings on peace, but this is the first time for many years that we have had a meeting on preparedness.

*** Introductory Address of the Presiding Officer at the Third Session of the Semi-Annual Meeting.**

This is the third session of an all-day meeting on the general subject of democracy and preparedness, and if all of you could have sat in the meetings during the day, I think that you would have been impressed by the extraordinary scope of this subject of preparedness, the width of its boundaries. We have been thinking today not simply of preparedness for war but of preparedness against war.

What are the boundaries of this subject? We need, of course, a strong Navy, a strong Army, capable of being expanded in the emergency; we need an air force; we need especially research, which will be sure in air and other branches of service. But for true preparedness we need much more than that. We need a consistent and effective foreign policy. The United States has grown in power faster, perhaps, than it has grown in its ability to agree upon a foreign policy. Witness the number of occasions when the executive has negotiated a treaty but the Senate has not ratified it.

Beyond a foreign policy we need a trade policy, for out of deficiency of trade arise many of the causes of war. The Hull policy is an approach to that program. Besides a trade policy, we need a fiscal policy. Those of you who sat in today's meeting listened to an interesting paper by John Williams. Some of you may remember the extraordinary address on that subject by Benjamin Strong in 1922 before the War College.

What is the essence of a fiscal policy for preparedness? Well, the authorities generally agree that if you are to avoid the disturbance that arises from war finance, you must as far as possible finance your war out of taxation, and borrow as small an amount as possible. How adequate is the state of preparedness, when you start with a budget which is three or four billion short of being met by taxation, when you are already borrowing that amount?

We need monetary policies as a part of our preparedness program. Ordinarily, we have thought of monetary policies in terms of credit. In recent years, however, the problem of monetary policy has been a problem of the currency units and their varying values. What shall we say of a policy of preparedness under which one country is sucking to itself gold from all over the world, and already has more than half of the world's gold, and in the first four months of this year is

receiving an equivalent of the total annual gold production of the world?

But beyond monetary policies, there are domestic economic policies. In last Sunday's paper Professor Einstein pointed out that in resisting fascism, both internally and externally, the necessary basis for defense is a confident people, a people employed, a people looking to the future in hope. That is part of preparedness. We had a paper at the morning session on the question of education. Are we training men and women who will face these problems of preparedness?

One could go on and point out the relation of preparedness to our economic and social life. The necessity, it seems to me, is to look at the problem through new eyes, and we can do that if we secure new vantage points from which to survey it.

Tonight, we are going to do just that. We have representatives of a number of fields who can speak from their own experiences. The first speaker in himself embodies more than one point of view. When I first knew him, he had just taken the position as Special Assistant to the Secretary of War in the War Department. He came there as a business man to advise with Secretary Baker about business problems. After the War, he went back to his own business. In 1919 and 1920, he served as a member of the President's Industrial Commission. From 1931 to 1934, he was Chairman of the Massachusetts Commission for Stabilizing Employment. In 1932, he became President of Amherst College. So he knows several different approaches to this problem.

It is a very great pleasure for me to introduce President Stanley King of Amherst College! (Applause)

THE ORGANIZATION OF INDUSTRY AND LABOR FOR WAR

STANLEY KING
President of Amherst College

I am sure I do not need to say that I am not speaking tonight in my capacity as president of a small New England liberal arts college, nor am I speaking as an expert on the subject which has been assigned to me.

In 1917 and 1918, there was a small group of us under the Secretary of War dealing with certain problems which he referred to us, and we called ourselves the piccolo players. If you know the story of the piccolo player, you will understand the implication. (Laughter) I am speaking tonight as a piccolo player. (Laughter)

This morning and this afternoon, many of us listened to a number of addresses dealing with the subject of preparedness from different points of view. My subject tonight, as assigned me, was not the subject of preparedness but "The Organization of Industry and Labor for War". If I were to talk on the organization of industry and labor for preparedness, I should deal with it somewhat differently, because the first question that would arise would be, How much preparedness?

Obviously, if this country undertook a modest preparedness program, no serious problems would arise in the organization of labor and industry at the beginning, because we have an adequate plant capacity and an adequate man power in the country, more than adequate to meet the need of the country today for its civilian demands. If, on the other hand, we were to undertake here a preparedness program of the order of magnitude for the United States comparable to the preparedness program being undertaken in Great Britain, then serious problems of the organization of labor and industry would arise, and those problems would arise gradually as they are likely to arise in Great Britain in the next twelve months, if Great Britain continues its program of preparedness on the terms now outlined.

But the problem of the organization of industry and labor for war is a more difficult problem still, as you recognize, than even a preparedness program of the order of magnitude of Great Britain's, and it is that problem that your officers have asked me to discuss this evening.

It is a simple question, as you see, without complexities. After the World War the British treated the subject through a group of civil servants, who were in charge of it in the war, in twelve volumes which were printed by the British government but not published; printed to be available for any government of the future. I have not had access to those volumes, but I am confident that those twelve volumes in the archives of the War Office in Great Britain have been the subject of the most serious study over there for the past twelve months at least. My problem tonight is to deal with it, not in twelve volumes, but in twenty minutes.

First, let me sketch some elements of the background which seem to me relevant. When we entered the World War in 1917 we had a government debt of something like one billion dollars and an economy which was generally accepted as stable. Now our government debt is in the neighborhood of forty billion and our economy is, shall I say, less stable. In 1917 we had a wage level which had risen gradually but not spectacularly for perhaps a score of years. Today the wage level is some 200 per cent above 1917 in money wages and some 100 per cent above 1917 in real wages. Furthermore, this advance has taken place largely within the few years since 1930 and is, I am told by economists, unprecedented in history. This is the second relevant item in the background, relevant to the cost of a war.

Third, let us look at the question of hours of work. In 1917 the average hours of work in manufacturing industries of the country were perhaps fifty. In recent years they have dropped to approximately forty. This is relevant to the speed with which we can equip our forces. Finally, let us consider the question of labor policy. In 1917 the federal government had no labor policy. If disputes arose resulting in a stoppage of work, the two sides dealt with their problems, sometimes with the assistance of conciliators from the federal or the state Departments of Labor; sometimes disinterested citizens were called in to arbitrate. But our government had enunciated no policy on labor matters, either by act of Congress or by executive pronouncement. Today we have a government policy. It is embodied to some extent in the preamble of the Wagner Act and to some extent in the precedents which have been developed by the National Labor Relations Board in its decisions under the Wagner Act. I express no opinion either as to the policy which Congress in its wisdom has adopted or as to the instrumentalities through which this policy has been implemented. I call attention only to the fact.

All of these factors are important and all are I think relevant to the question which has been assigned to me this evening. They seem to me to make the problem of the organization of industry and labor for war far more difficult in 1939 than was the problem presented in 1917. And this difficulty is enhanced by the division of American labor into two hostile camps: the American Federation of Labor and the Congress for Industrial Organization.

In January 1917, the government of the United States was not organized to enter a major war. The problems of procurement of supplies for the armed forces had not been thoroughly studied, the problems of labor which we faced had been envisaged hardly at all. Shortly after we entered the war the Balfour Mission came to Washington with a group of experts and placed at the disposal of our government the relevant experience of Great Britain. From the experts who came over with Mr. Balfour we learned much of the British experience in these fields in the three years which had elapsed since August 1914.

Today the case is different. Not only are our two services acutely aware of the industrial and labor problems which the country would face in the event of war, the Congress has been made aware of them, and on some aspects of the problem the public is informed.

Under the leadership of Assistant Secretary Johnson of the War Department and Assistant Secretary Edison of the Navy Department, prolonged and thorough studies have been made. It is fully realized that we must have on hand reserve stocks of raw materials for which this country has to depend on foreign countries. Familiar examples are chromium, ferro-

manganese, tungsten and rubber. Our utility industry has been informed that in the event of a major war we should need at least one million kilowatts of additional capacity, and possibly a second million kilowatts. The War Department program provides for the allocation to "educational orders" of non-commercial products so that factories may be prepared to put these as well as commercial products needed for war purposes into mass production promptly in case of need. The new Congressional appropriation of forty-two million for educational orders is to finance this aspect of the program. The War Department proposes to have on hand enough supplies to carry its initial force of four hundred thousand soldiers over the first six months. At a meeting in this city a month ago addressed by Assistant Secretary Johnson and Admiral Woodward of the Navy, these industrial problems were discussed in some detail. It is obvious that no elaboration from me is needed this evening. We can, I think, agree that our government is fully alive to the problem of mobilization of industry in case of war, and we can assume the bills have been drafted and filed away for prompt presentation to the Congress if and when we find ourselves at war.

But there are major problems of labor which will confront the country in such an event and these have had less public consideration. It is to these that I propose to address myself this evening. In these problems we have had some experience, for they became matters of vital importance to our military program in 1917 and 1918, and our experience then suggests the approach I believe we should follow, in the unfortunate event of involvement in another major war.

What are these problems which are embraced under the general category of labor problems? The possible control of wages; the possible control of prices and cost of living; the possible extension of hours of work if such action seems necessary; the mobility of labor; the prompt solution of disputes which arise; and so far as possible, the elimination of stoppages of work on government contract for war supplies. And perhaps more important than any of these specific problems is the problem which was faced in 1917 and will be faced again in the event of war, of keeping out of the armed forces of the United States the essential workers in the essential industries so that our arsenals, navy yards and munitions plants may not be deprived of the essential technicians among the workers. And finally, what effect, if any, has the current controversy between the A. F. of L. and the C. I. O. on the problems which would then face the country?

In a consideration of these questions, one problem is central and fundamental. It is the question of the conscription of labor. We may assume I think that our government in case of a major war will find it necessary to apply conscription to recruit the armed forces as it did in the last war. We may assume that the government may and probably will in individual cases, if not in general, find it necessary to apply the principle to certain industrial plants. In the World War, under section 77 of the National Defense Act, the President had the power, which he exercised in rare cases, of commandeering a plant and operating it under the officers of the War and Navy Departments. In the World War there was a body of opinion which from time to time urged the conscription of labor. Of course the conscription of labor is accepted as sound doctrine in totalitarian states. Even in peace time the rulers of Germany and Italy make clear that every citizen from childhood to old age is the servant of the state and is to be used by the state where and when and under whatever conditions of employment the state may determine. Should our government in a major war adopt such a policy? If not, how can the government be assured of the necessary man power to equip and keep equipped its forces in the field of action?

My own answer is clear and unequivocal. I believe in conscription for the recruitment of the armed forces. I believe the President should have the power to commandeer industrial plants if and when it becomes necessary, but I am opposed to the conscription of labor. I oppose it not because I find any logical difference between conscripting John Smith to go into the infantry and conscripting James Jackson to go into an arsenal or munitions plant, but because in a democratic country, with democratic traditions, I believe the conscription of labor is inefficient. I should rely on the doctrine of consent, as we did in the World War. I believe that under this policy the workers in an arsenal or in a munitions plant will turn out more rifles and better rifles than will a shop's crew in uniform and under military discipline. I believe this point of view is supported by a wealth of experience.

But if you accept with me this fundamental premise, I then add that we must implement our policy with great care and foresight and that we must develop a competent organization to administer the program. And I may add that the implementation and the organization which would be adequate in peace time would be found unsatisfactory under war conditions.

Why? Because in peace time the government may have, and our present government has, certain social aims and objectives which its program of legislation in this field hopes to advance. In war time the government has one objective which must overshadow all others, namely, to terminate the war victoriously at the earliest possible date. This point of view was expressed with clarity by Secretary Baker in a memorandum to the munitions manufacturers of Connecticut under date of November 21, 1917—"The War Department has no theories to exploit and no other purpose except the one which I hold in common with you and your workers, to see that our armies in the field are not disappointed and rendered powerless in the presence of their adversary through the failure of the necessary supplies for the procurement of which contracts with you are made." And a second reason why the organization which is adequate in peace time will be found unsatisfactory under war conditions is that the organizations which in peace time handle matters of labor relations use certain technics appropriate to peace time and acquire certain reputations which are not in my opinion a sound background for dealing with the problems of labor in war, when a continuous flow of production of munitions is the primary criterion.

Let me be concrete. The department dealing with the problems of labor in war times should be independent of the Department of Labor. In the last war this work was carried on directly under the Secretary of War or under the Secretaries of War and Navy. I believe our experience then justifies the conclusion that this procedure is sound. The Department of Labor will continue its normal activities in plants producing supplies for the civil population. But the problems of hours, wages, and settlement of disputes in plants producing for the War and Navy Departments should be dealt with by agencies reporting directly to the Secretaries of War and Navy. These agencies should be manned by men and women of experience and competence. They should be civilian. They should have no social theory to support or advance. They should be coördinate with and not subsidiary to the procurement divisions of the War and Navy Departments.

What of the National Labor Relations Board, which has been set up under the Wagner Act? Its modification is today the subject of acrimonious discussion and debate. I am not competent to comment either on the Wagner Act or the National Labor Relations Board as an instrumentality for accomplishing certain social projects. This is a peace-time problem. If, however, we should become involved in a major war, it is my judgment that both the Wagner Act and the National Labor Relations Board should be suspended for the duration of the war. There is a substantial body of opinion both among responsible employers and in responsible labor circles which is critical of the present Act and its administration. Whether the criticisms are well founded or not I cannot say. But I do suggest that in case of our involvement in war these questions should be laid on the table and left to be settled after the peace treaty.

How does one apply the doctrine of consent? In the World War the first enunciation of government policy in regard to labor was made by the Council of National Defense on April 23, 1917, two weeks after the declaration of war.

Were we to become involved in another major war I suggest that the President might deem it wise to call to Washington *at once* a policy board on which, in addition to government representatives, there should be responsible representatives of industry and ranking officers of organized labor. Such a policy board may well present to the President a recommendation outlining the general policies under which the questions would be dealt with by the government. Of course such a board should include representatives of both the A. F. of L. and the C. I. O. Vigorous as are the differences of opinion today between these two organizations of labor, we may accept, I believe, as axiomatic that the rank and file membership of the unions in the Federation and of the unions in the C. I. O. and the leadership of both groups are patriotic citizens prepared to submerge for the duration of the war their present differences.

At the same time that a policy board is meeting in Washington at the outbreak of war to set down by mutual agreement

the labor policies which are to be followed, the government will need to establish at once a comprehensive organization for war labor administration. The direction must be in Washington. The personnel for detailed administration will be decentralized in branch offices at every important center of munitions and supplies for the Army's purposes. The experience of Britain as well as our own experience indicates that the personnel of the war labor administration not only should be composed primarily of civilians, but should act as civilians.

You will gain some insight into the magnitude of the undertaking and into the extent of the responsibility from the fact that on November 11, 1918, the War Department of the United States was the dominant factor in the industrial and labor situation of the country. Its employees, direct and indirect, included the majority of all industrial workmen of the country. Its functions and activities in the field of labor activity included not only the adjustment of disputes on the fixing of wages and hours in many industries, but an intimate contact with such relevant subjects as housing, employment management, community organizations, etc. There was no aspect of the labor problem into which it did not enter.

We have discussed the fundamental doctrine of consent, the methods of implementing it, its civilian administration. One problem remains. What sanctions can be applied by a war labor administration in a democracy to secure compliance? This problem is simple in principle, even though difficult of application. Our experience in 1917 and 1918 indicated that under the war powers of the President and the war legislation adopted by Congress, adequate and varied sanctions existed for use if and when in the opinion of the President or his representative compliance could not be secured by other means.

The organization of a democracy for war seems complicated and difficult and oftentimes inefficient. It was so in 1917 and will be so again. Preparedness for war on the part of a democracy requires in the field of industry and labor more careful advance planning, more thorough and prolonged consultation, more wisdom in the choice of personnel than is required in a totalitarian state. The detailed study of the program is an important peace-time function of our War and Navy Departments. (Applause)

Remarks by the Chairman

President Burgess: Thank you very much, Dr. King! There must be more to this piccolo-playing business than most of us have suspected. (Laughter) I think that there is a part of that story which he forgot to tell you. As I understand it, one of these three piccolo players was already a college president and the other two became college presidents — so it is a very effective instrument. (Laughter)

I have a disappointment for you tonight. General McCoy came to New York to make his speech, but last night became ill. He had hoped during the day that he would be able to appear on the program, but his doctor has finally decided that he cannot be here. He is not seriously ill, but it would not be wise for him to come out tonight.

He had, happily, written out his speech, and one of his fellow officers is going to read it. Before I introduce him, however, I shall improve this opportunity by saying something about army officers that I have been wanting to say in public for about twenty years. (Laughter) It isn't what you think! (Laughter)

I have been dusting off the old figures, and they bear out my recollection to this effect: That a rather small group of regular Army officers, who held commissions at the beginning of our participation in the Great War, did an extraordinarily effective piece of work in mustering into the Army four million men and in sending overseas two million men so well trained (with a brief training averaging eight or nine months, even less with the later divisions) that they were able to stand against the most experienced troops of Europe. Aside from the ability of the regular officers, who handled this problem in man power, there were other reasons why we could do that job, and I think that they constitute a chapter in the history of army development well worth pausing over.

In 1880, a distinguished general, Emory Upton, wrote a book called *The Military Policy of the United States*, in which he reviewed what happened in the Civil War and the very unfortunate experiences of that time in handling man power. He listed ten points as causes of weakness in the Army of that time, and I am going to read them. They are not long.

The causes of weakness are as follows:

First, the employment of militia and undisciplined troops commanded by generals and officers utterly ignorant of the military art;

Second, short enlistments from three months to three years, instead of for or during the war;

Third, reliance upon voluntary enlistments, instead of voluntary enlistments coupled with conscription;

Fourth, the intrusion of the states in military affairs and the consequent waging of all our wars on the theory that we are a confederacy instead of a nation;

Fifth, confusing volunteers with militia and surrendering to the states the right to commission officers of volunteers the same as officers of militia;

Sixth, the bounty—a national consequence of voluntary enlistments;

Seventh, the failure to appreciate military education and to distribute trained officers as battalion, regimental and higher commanders in our volunteer armies;

Eighth, the want of territorial recruitment and regimental depots;

Ninth, the want of post-graduate schools to educate our officers in strategy and the higher principles of the art of war;

Tenth, the assumption of command by the Secretary of War.

General Upton, when he wrote his book, said he did not expect anything to be done about it for five or ten years, and nothing was done. But in the early years of this century, when Elihu Root was the Secretary of War, and particularly when Leonard Wood was Chief of Staff, every one of General Upton's recommendations was gone over, and an army organization and procedure and principles were adopted which meant that when we went into the Great War, we committed no one of these ten errors that we had committed in previous wars. In other words, here is an example of a careful analysis of the problem and of preparedness to deal with the situation. Our Army had a general staff; we had War Colleges; the whole thing was set up on an entirely different basis, partly due to the analysis of General Upton.

I speak with some hesitancy in the presence of military men, but if I have said anything wrong, they have a chance to correct me later.

I think that if one looks at the figures, one finds that our tremendous industrial machine proved less effective in war than our dealing with personnel. Early in the war we wrote articles telling how the skies would be darkened by American airplanes. Only a very small spot of sky was darkened and that not until the middle of 1918. Our men fought with French guns, largely with French shells. In other words, there had not been the same anticipation in the matter of *matèriel;* and munitions could not be improvised with anything like that rapidity.

The other thing that I want to say about the Army officers concerns their record as statesmen-soldiers in the Philippines, in Puerto Rico, in Cuba and in other countries. Of that no better illustration can be found than the career of General McCoy, who was to be with us tonight. He fought in two wars besides the conflict at the Mexican border; he served in Cuba and the Philippines as an administrator. He was a member of special missions to Armenia, to the Philippines, to Japan, to Nicaragua, and to Bolivia and Paraguay in connection with the boundary disputes of those two countries. Many of you know him here as a former Commander of the Second Corps Area.

General McCoy's paper will be read to us by Colonel Ulysses S. Grant III, the son of the distinguished General Grant and grandson of the great General and President. In his own right he is an example of the soldier-statesman. As I have said, he served with General Bliss at the Supreme War Council. He stayed there with the Commission to negotiate peace and served with that Commission. More lately, in the years from 1926 to 1933, he was Director of Buildings and Parks in Washington, at the time when the new plans were made for those splendid buildings that you now see in Washington, when Major L'Enfant's plans were brought out and revised and extended. He taught at the War College and he is now Chief of Staff of the Second Corps Area.

It is a great pleasure that we have a chance to introduce to you directly Colonel Grant, as well as General McCoy indirectly. (Applause)

A SYSTEM FOR THE CONDUCT OF WAR BY OUR DEMOCRACY

MAJOR GENERAL FRANK R. McCOY *
United States Army, retired
Former Army and Corps Area Commander

UNDER the topic of the evening, "Democracy and the Issue of Preparedness", I have chosen to discuss and consider a system for the conduct of war by the American government. In following the tragic trend of events abroad during the past few years, every one is concerned at the quickness and direct action of the aggressor states. The greatest problem of our democracy then becomes how to counter this threat to our security and devise methods for meeting possible and even probable emergencies quickly and decisively.

In studying the functions of other governments with their parliamentary forms, I am convinced that our own government and its particular set-up under the Constitution is the best and strongest organization, for both preparing for and waging war. However, it is still geared for peace, and its experience has heretofore, fortunately, been for Kiplingesque wars, or for slow wars.

While we have time it behooves us to study how its direction and administration can be improved and quickened. During the past six months we have all had a liberal education in preparedness, so far as the needs of the Army and Navy are concerned. The general public, when considering the conduct of war, is apt to think of it in military terms—newer and better and bigger guns, faster airplanes, reserves of munitions and battleships. This is the obvious understanding of preparedness, but to my mind it is about 25 per cent of our needs and efforts. I believe at least 75 per cent of the effort of the modern government at war is political and civilian. All the King's horses and all the King's men won't win a war, unless properly directed, controlled and supplied.

* General McCoy's paper was read by Colonel Ulysses S. Grant III.

The civil side of the government should predominate so that the operating agencies—the State Department, the Army and Navy—can be free to function with the full support of the government. That involves freedom of action on the part of the President, in his control of foreign affairs and as Commander-in-Chief of the Army and Navy. The President has ample powers under the Constitution, either in being or abeyance. We all have the traditional fears of executive power; the founding fathers had it, but they were faced with a weakness of government which they feared the more. So they gave us a strong government with ample powers, which have been interpreted and confirmed by the Supreme Court and which in time of war and great emergency Congress has given freely, but temporarily, to the President. It gave such powers to General Washington, to Abraham Lincoln, and to Woodrow Wilson, without lasting effects on our traditional form of government. What Congress can give it can also take away, and has taken away when the emergency was over.

There are present here many of the leading public men, business men and scholars, who gave of their time and talent to our country on the civil side during the Great War. That experience, I am sure, was cherished by all of them. At the same time, in reminiscing with them and you I have been conscious how often you have talked about the agonizing delays and lack of coördination which you attempted to counter by cutting red tape. You were only temporarily successful, for that Gordian knot still persists in our government. Most of it is the result of laws, amendments, provisos and reservations on the part of government for peace-time functioning.

With your experience in the efficient conduct of private business you must realize the impracticable situation of the President, under the present slow conditions. It is sufficient to call attention to the fact that, with the President in political leadership and the public supporting the recent provisions for modernizing, strengthening and quickening the Army and Navy, five months have elapsed since responsibility was put upon Congress by the President. The needs of the services have finally been authorized by Congress in practically the same form as presented, but, even so, under the peace-time checks and balances, it will take from two to three years to accomplish

what Congress fully intended from the first of January. The same lack of coördination and cross efforts that you were so conscious of during the Great War still persists.

General Atterbury, in discussing efficient control of great business organization, remarked to me that as President of the Pennsylvania Railroad he felt that he could supervise and coördinate only five vice-presidents. You, as chairmen of boards and presidents of great companies, I think, will agree with him when you sense how quickly you can act; how much time you have for planning on the broader scale and meeting business emergencies. Think of the President of the United States, with not only his ten Cabinet officers but some thirty commissions and services more or less independent.

Every President, from Theodore Roosevelt to Franklin Roosevelt, has earnestly endeavored to reorganize our government. Theodore Roosevelt had his Keep Commission, Mr. Taft his Cleveland Commission, Mr. Harding his Brown Commission. In none of these studies, analyses and reports, including the recent Brownlow report, has the government been considered or studied for waging war. All of these efforts have been for better peace-time functioning. Of course, efficiency in peace time will bring results in war time.

It is also curious that, although we have had war in every generation, in the courses of the schools of government, and in the departments of political science of our splendid universities, with constant study to meet and remedy the social and political evils of government, the greatest evil of all, War, has rarely been touched upon; and then in an emotional way. I am conscious of only two of our learned institutions seriously studying and planning for conduct of war, should it come. There seems to have been consistent failure to look the grim war in the face. Only in this very year is a serious study being made—that by Dr. Harold Tobin, Professor of Political Science at Dartmouth, the results of whose work will be published by the Council on Foreign Relations during the coming year.

In the meantime, for the burning present, I suggest your urging that Congress itself, by a joint commission, study its war powers and how it can best support the Commander-in-Chief, the State Department, and the Army and Navy.

I suggest that the President of the United States, in his reorganization of the executive side of the government, appoint a civil commission to apply the Brownlow report to war preparation and a system for the conduct of war by the executive. Mr. Roosevelt has in the past year shown that he understands this himself, in so far as he himself acts by bringing into conference not only the military and naval advisers but those of the Department of State. However, these departments, of necessity, speak a varied language. They seldom agree on broad and vital questions, not from any service jealously or lack of understanding, but they naturally approach moot questions in different ways. The State Department is largely a department acting on precedent and has, through 150 years, built up a very wide and sound way of acting on national and international questions. The Navy acts directly and quickly, because it has a fleet in being, ready to go to war tomorrow; whereas the Army, in its preparation for war, is a slow organization, and, from our experience, takes from two to three years to be ready for war.

With this natural disagreement on vital questions there should be a coördinating body or executive committee, or a deputy of the President who would properly prepare these problems for a quick and direct decision, not waiting for a casual conference. This could be done by executive order. The State Department should have a planning body, divorced from the daily dozen, working intimately with the War-plans section of the General Staff, and the Operations of the Navy.

All this requires teamwork, such as we Americans are determined to have in our sports, let alone in our waging war, which is the greatest game of all. Once again, I insist that the public, the press and the statesmen should know the part they are to play—understand one another, and not be at the mercy of popular clamor or immediate danger.

In this wishful thinking I close by offering up that ancient prayer:

"Lord, I believe; help Thou mine unbelief."

(Applause)

REMARKS BY THE CHAIRMAN

PRESIDENT BURGESS: Thank you very much, Colonel Grant!

Of the various explanations of the causes of the tides in the affairs of men—depressions, prosperities, political changes—one of the most interesting is that there are cycles of leadership. We had great prosperity in this country in the twenties, partly because there were a good many active, energetic leaders pushing large undertakings employing labor in various fields. Many of those leaders are no longer active today. The explanations are many. Some of them appear on the books of the banks (laughter); some of them suffered because of changes in popular prejudice. The old leaders are no longer accepted, in some instances, as leaders. And so you go through a period, perhaps, wherein there is a lack of leadership.

It was a great thrill that all of us got to hear of a new leader sprung up in the great state of Massachusetts, a graduate of Harvard, a lawyer, a director of business concerns. It was no accident that he became interested in politics. He did it the hard way. He was an Assistant District Attorney of Middlesex County; he was a member of the Board of Aldermen of Newton (that certainly was hard) (laughter); he was a member of the Massachusetts House of Representatives, beginning in 1923; he was the Speaker from 1929 to 1936, and then he was elected Governor of Massachusetts.

I have great pleasure in introducing to you the Governor of Massachusetts, the Honorable Leverett Saltonstall! (Applause)

DEMOCRACY AND THE ISSUE OF PREPAREDNESS

THE HONORABLE LEVERETT SALTONSTALL
Governor of Massachusetts

MR. Burgess in his opening remarks stated that he had an aide of a general on his left, an aide of a general on his right, and implied a certain comfort in the position in which he found himself. But he forgot that in between was a politician! (Laughter) And it is extraordinary how a politician does come in between the generals and the admirals and muddles things up here and there for those eminent fighters in time of war.

I also note that on your program you have chosen to end the day with a politician, and the only politician that you have asked to speak to you today. Perhaps that is right because when you come right down to it, in all this question of preparedness and the preservation of democracy, the politician, if he rightly expresses the attitude of his constituents, does have the final say.

In discussing with you the subject tonight, it might be permissible for me to talk as Commander-in-Chief of the National Guard forces of the Commonwealth of Massachusetts (laughter) but for a "shavetail" in the War who suddenly finds himself the Commander-in-Chief, I think that might prove a little embarrassing (laughter) and I am confident that that was not your intention.

When the Academy invited me here, I did, however, wonder just what I could contribute to a program featured by experts in warfare and diplomacy. I am the Governor of one of our forty-eight states and, as such, it is my duty to devote all my strength toward meeting the perplexing domestic problems of our citizens. But I reassured myself that in my civic capacity I could indeed stand before you as in some degree an authority on preparedness. For I am convinced that the kind of government which we in legislative chambers, in city halls, and in state capitols are striving to provide is the bulwark of our

national safety. Democracy is not simply a patriotic relic which we must preserve. If we guard against its ever getting rusty, it is the strongest weapon we have for our defense.

You have just heard Colonel Grant describe the views of one of this country's foremost soldiers—General Frank R. McCoy—a real fighter, as well as a keen student of military affairs. He knows far better than I, the nation's need in guns and men. But let us grant we provide the Army with all the equipment it asks; let us suppose we supply the Navy with the biggest possible fleet; and both branches with a tremendous air force. Let us have the best Generals and Admirals in the world—and plenty of funds to support them, and the coöperation of industry and labor, under the methods described by Dr. King. We still need something more—something even greater and more powerful to support this great armament and these brave fighters! We need a strong, united nation. And this strength can lie only in the confidence of the people in their government.

First of all, we must have the right type of government. In this we are singularly fortunate, for the democracy which our forefathers created has given us the foundation for the strongest government on earth. Time has satisfactorily tested the framework of our system—a system founded on rule by the majority; on protection of the rights of minorities and individuals; on the distinct separation of executive, legislative and judicial powers.

But we must have more than a framework of democracy. We must have an expanding democracy, a government which meets the growing needs of our people. The services which a representative, democratic government performed in 1790 are not enough in 1939. The founders of our country knew no master except necessity. When our government was established on these shores, it consisted of just three functions: protection from external enemies, protection from internal enemies, and provision of enough revenue to pay for the first two. Now it still consists of these three—and many more besides. Recent generations have been born with the silver spoon of democracy in their mouths. We of the present generation now must work again on our own; we must acknowledge the return of that stern need of fighting to preserve our system of government. We must not only talk democracy. We must live it. The trend everywhere today is toward a different order. We must be sure that here it is toward a better order; that democracy is enlarged and not curtailed.

It is more than ever essential under present world conditions for our people to feel satisfied with their government and confident that it is really meeting their enlarged needs. If our democratic form of government is going to ensure the safety of this nation and play its part in the preservation of civilization, it must be able to meet the competition of the dictator countries. It must be able to match their armed moves, if, God forbid, the crisis should ever reach that stage. It must be able to survive the undercover, insidious penetration by which modern aggressors are conquering without firing a shot. In such conflict there are big odds in favor of the one-man power which, without regard for the voice of its people, can be quick and deadly on the trigger.

Our popular government can and will provide real preparedness against such foes. But to do so, it must have the united support of its people. To do that it must have their complete confidence.

The extent of that confidence depends directly upon our ability to satisfy the average citizen that our form of government is the best type of government for him and his family.

In these modern, complex days, what does the average citizen expect of his government? Most of all he wants a job. He wants security of employment; and if there is temporary loss of a job, he wants to feel that his children will not go hungry and his house will not be without fuel. In short, he wants to feel a security of living.

He wants to work, but he does not want to be a slave. He wants some leisure time and he wants to feel that the hazards of employment do not entirely fall upon his shoulders.

He wants justice, not only honestly, but promptly and efficiently administered. He wants to be decently housed and the health of his family protected. The future of our country depends on the health, well-being and safety of our average citizen.

He wants to see his children educated. Democracy must interest itself, moreover, to an even greater extent than that

in the youth of this country. For the last six years, youth has been wondering and asking questions. The young people want to begin their lives early. They want to marry, but it is difficult for them to obtain jobs, either in industry or in government. Our future depends to a large extent on our ability to solve the problem of youth.

The average citizen expects the federal government to participate in a real partnership with states and municipalities in providing for him when he is in need, and he expects the administration of this aid to be entirely free of politics, absolutely honest, and guided only by the principle of assistance to him who really needs it.

In brief, the present laws and demands for social security and for old-age security, for solving the problems of young people, have become and will continue to be functions of our government. If it does not provide these requisites, then it will lose the confidence of the average citizen, and he will begin to look for some other form of government.

We know that to do this government must function within its ability to pay. This means in tough times, that to maintain the essentials, all waste and frills be eliminated. If the essential functions are to be carried out well, if they are to be broadened in scope and improved in quality, then we must be certain that the resources of government, and also of its subdivisions, can stand the added expense involved. A government must not pass laws and then be unable to perform them because of lack of funds—a condition we have seen lately come to pass in several sections of our country.

That leads us to the big and important task of bringing home to our average citizen an understanding that the functions of government which he expects from his community, his state and nation are dependent upon the financial soundness of the government which supplies that service. Many citizens, because of the complexities of modern civilization, have little realization of the problems involved. If we can give them a clear and honest picture of the obstacles, we shall be going a long way toward holding their confidence, and consequently preserving our form of government and all that it means: our liberties, our freedom and our security.

To provide adequate preparedness, our democracy not only must hold the confidence of its people, but also must possess the ability to make decisions. This ability to make sound decisions again depends on a better understanding of affairs by the people as a whole. They must be educated to their part in government and have a sound conception of the problems. In this respect, the service of your Academy of Political Science is immeasurable. Your initiative is kindling an enlightened knowledge of these complex and perplexing issues in all our citizens. Epictetus, the stoic philosopher, wrote that "the ruler has said that only free men shall be educated; but God has said that only the educated shall be free."

They must realize the dangers which face them at home and abroad. If they are aware of the extent of these perils, they will better understand the responsibility which rests directly upon each and every one of them, to choose leaders who will make wise decisions—leaders who so command the public trust that their timely decisions will be accepted promptly in spite of minority opposition. Such responsibility applies to the far-sighted selection of the President, members of Congress, and right down the line through state and local officials.

Every public official makes decisions. It is his responsibility to make sound ones. It is the people's duty to recognize and accept sound and necessary decisions when they are made. Our democratic form of government may not always produce perfect solutions to particular problems, but it does permit us, through reason and argument, to reach decisions which benefit the majority, for the time being, yet which satisfy minorities, for the time being. For example, the conscription law in England met strong opposition, yet after the call came, England has gone ahead. You have heard of no lingering resistance. The essence of democracy is freedom for disapproving voices. But only a democratic government which is trusted by its citizens can openly arrive at momentous decisions promptly enough to assure its own safety.

To safeguard its citizens, our American democracy must make the important decision as to just what constitutes "adequate" armed defense. It is not simply a question of supplying funds and men; or rushing the construction of battleships and airplanes, although that in itself is a task requiring our

best intelligence. It is a question of expending this vast effort most economically and most effectively. In deciding how this nation can best defend itself, the people, through their chosen representatives, must dispel any fog of political motives. They must insist that the program is big enough to meet real threats, but is not blown up beyond the demands of any possible dangers. They must insist that the preparations are concentrated where they will do the most good under present and predictable forms of warfare. To ensure this effectiveness, we must insist on coördination of the building programs and far-flung defense preparations of the several branches of our armed forces. We must know what we are doing. Only with that kind of preparedness can we swing into action promptly, when need arises.

In the field of diplomacy, the vital necessity of a sound foreign policy definitely requires this same ability to make decisions. We must have freedom in conducting our foreign relations. We need men trained to handle this highly specialized and delicate business; men in whose judgments the public will have the utmost confidence. Furthermore, only if our country is in good shape internally, can we as a people make free decisions that will make our position more secure in international councils. The only effective decisions are those backed by the people, not subserviently under the whip of dictators, but with independent and intelligent spirit; and with conviction that the decisions are right. Our immediate future in democratic government depends on this.

When our leaders reach a conclusion, even though supported by the public, we in a democracy must make a tremendous, concerted effort to act forcefully to uphold our position. To skeptics who doubt that we, as a popular government, can mobilize our resources so efficiently as can one-man régimes, the answer is that fear and hatred mobilize armed forces quickly, but do not produce lasting loyalty. Yet, to ensure this ability to act, we must expend every energy to set our own house in order. The United States must adopt policies in economic, industrial, and all other fields which will develop a maximum of production; and then we must administer them efficiently. An indecisive nation cannot act and does not frighten dictators.

In order to generate the vigor and energy necessary for effective action, a re-born democracy must rise from the old cradle of liberty. We must regard our government not as a fountain from which all blessings flow, but as a leader of a united people, who will all strive together with a common self-reliance. If this nation of 130 million individuals, of all races, can govern itself to its own satisfaction, it will be the most powerful example to the world that a democratic, free government will actually carry out its determinations with speed, force and ultimate success.

Finally we ask ourselves—can a practical democracy of the kind which is within our grasp compete successfully with dictator nations? I say, yes! A thousand times, yes! This I maintain with the realization that the menace of dictatorships goes far deeper than military attacks. Something stronger than armed defense is required to meet that type of menace. We are becoming all too familiar with the new technique of aggression. Its tactics consist of penetration instead of destruction; incitement of internal strife; fomentation of racial prejudice; tampering with religion; drugging of youth with military cocaine. It is a superwarfare of ideas, where lies are sent into the trenches against truth.

A nation that is disunited and discontented is ripe for picking by today's war lords. To check such invasions there are even more impregnable forces than aircraft or battleships. They are natural forces in which our nation is peculiarly rich: an unquenchable love of freedom; an unwavering insistence upon the individual rights of man; an unbeatable spirit of fair play; an unbreakable will never to quit in the face of adversity.

With these forces, I say we can compete with dictator nations. Coöperation is something we understand here. We do not cast out our finest scholars and scientists because we do not like their race. There is no limit to the number of brilliant and earnest minds working on our problems. Can there be any doubt that such combined output will be better than the product of one leader's will, which forbids the existence of all other minds? Can there be any doubt as to the superiority of a nation fostering the best instincts of family life and of religious emotion to those where the state takes over the care and instruction of children and the highest emotions of man are directed to the state rather than to God?

Democracy may not provide the most efficient government, but it produces something which regimented governments cannot create: a boundless will and force that can overcome terrific obstacles. That energy and that determination show themselves in our rugged individualists. You can see it also in America's aptitude for team play. Our nation provides good material for winning football teams, but mighty poor stuff for chain gangs. On which type would you stake your fortune? Dictators know and fear this true power of ours as the greatest barrier to their ambitions.

Our basic need in strengthening this defense is a government which will permit and encourage all of us to live life as we know it should be lived: contented, vigorous, courageous. The leaders of today hold the key to that door of opportunity. Keep it open and we can have enduring security.

Democracy and the Issue of Preparedness are identical. True, virile Democracy *is* Preparedness.

Thomas Jefferson's passion for freedom, perpetuated in our democratic form of government, is our strongest safeguard. Freedom from dictation, prejudice and ignorance, he recognized as the strongest weapon in any struggle against oppression or aggression. History has repeatedly proved that he was right. His motto for the University of Virginia can still be our guide more than ever today:

"Ye shall know the truth, and the
truth shall make you free."

(Applause)

Remarks by the Chairman

Professor Burgess: In behalf of this audience, Governor Saltonstall, let me express our appreciation to you for this very fitting climax to the day's meeting, and let me also, in behalf of this audience, thank you, Dr. King, for coming here and giving us those extremely interesting thoughts, and to you, Colonel Grant, we are also very grateful.

I declare this meeting adjourned!

PROCEEDINGS

OF THE

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THE EFFECT OF THE WAR ON AMERICA'S IDLE MEN AND IDLE MONEY

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
NOVEMBER 15, 1939

EDITED BY

JOHN A. KROUT

THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY
1940

PREFACE

TWENTY-ONE years ago the Academy of Political Science was concerned with the effect of war upon the nation's economy. At that time many aspects of the problem were novel. Never before had industrial capitalism in the United States been subjected to the impact of military operations on so wide a front. It was not surprising, therefore, that many prognostications had to be revised in the light of experience. Against the background of that experience, both as neutral and belligerent during the World War, Americans are now setting the question of the effect of the present European hostilities upon our policies concerning money, materials, men and morale. Parallelism in history is often deceptive, yet the economists and publicists responsible for this volume of essays have found much in the economic and financial annals of the last war to help us make decisions in the days of troubled neutrality which apparently lie ahead.

The papers and addresses, here presented under the title of "The Effect of the War on America's Idle Men and Idle Money", comprised the program of the Academy for its Fifty-Ninth Annual Meeting, held at the Hotel Astor in New York City on November 15, 1939. The Committee on Program and Arrangements, modifying its plans to meet changes in the European situation, was fortunate to secure a group of scholars and commentators so well qualified to discuss special phases of the general topic. The officers of the Academy wish to express their thanks to those speakers, as well as to the Committee on Program and Arrangements, the membership of which is here recorded: John W. Davis (Chairman), Miss Ethel Warner (Director), Earle Bailie, W. Randolph Burgess, Frederic R. Coudert, Lewis W. Douglas, Leon Fraser, Charles R. Hook, Pierre Jay, Thomas W. Lamont, Sam A. Lewisohn, Roswell C. McCrea, Charles Merz, Wesley C. Mitchell, Shepard Morgan, William L. Ransom, Gordon S. Rentschler, Alfred P. Sloan, Jr., George A. Sloan, Edward R. Stettinius, Jr., Juan T. Trippe, John H. Williams, Leo Wolman, Owen D. Young.

CONTENTS

PART I

THE RECOVERY PROBLEM UNDER WAR INFLUENCES

INTRODUCTION*

W. RANDOLPH BURGESS, *Presiding*
Vice-Chairman of the Board, National City Bank of New York
President of The Academy of Political Science

THE subject of this Annual Meeting of the Academy of Political Science—and I may say in passing that this is its fifty-ninth year of holding these meetings—is "The Effect of the War on America's Idle Men and Idle Money". I think I shall tell you a secret of program making. These programs are always made, of necessity, well in advance. This program started as simply "Idle Men and Idle Money". And then came the war. That changed our whole approach. Of course, this is not the first meeting that the Academy has held in recent years on the broad topic of recovery. We have been at that for almost ten years, and in our recurring meetings it has been the subject that people wanted most to discuss. But for the first time this general topic is given an entirely new approach and a new point of view.

The morning session has the broad title "The Recovery Problem under War Influences". The first paper is a general look at the problem, "The Present Nature of the Recovery Problem". The speaker is known to all of you through his writings, and through his distinguished position as professor at Harvard. He wrote what to my mind is one of the best books on the recovery problem two or three years ago and has an article in the current *Atlantic Monthly*, which some of you have read.

I take great pleasure in introducing Sumner H. Slichter of Harvard University.

* Opening remarks at the First Session of the Annual Meeting.

THE PRESENT NATURE OF THE RECOVERY PROBLEM

SUMNER H. SLICHTER
Professor of Business Economics, Harvard University

I

FOR the time being the development of a war boom seems to have been checked. Possibly the fear of consumer resistance to higher retail prices (memories of 1936-1937 are still fresh), uncertainty concerning the duration of the war, and the many deterrents to investment which have retarded recovery up to now and are still in existence will prevent the development of a war boom. The danger, however, cannot be over so long as the war lasts and our own armament program is expanding. It is accentuated by the possibility that even a moderate expansion of demand may detonate a broad attempt by industry to catch up on the deferred maintenance of the last ten years, by the prospect that an expansion of employment will create a housing shortage in many localities, and by the vulnerability of our economy to increases in costs, particularly labor costs. Our present need is to take a long-range view of the recovery problem and to manage any temporary spurt in such a manner as (1) to minimize the shock of the inevitable let-down, and (2) to facilitate the resumption of recovery after the temporary spurt is over. This involves: (1) avoiding a substantial rise in the price level; (2) avoiding large increases in costs; (3) preparing a cushion for the inevitable let-down; and (4) raising the propensity to invest.

II

The case against a substantial rise in prices is obvious. Not only does the rise generate the kind of business activity which is essentially temporary and subject to sudden and severe contraction, but it induces an expansion of short-term debts that accentuates the subsequent recession, and, most important,

it produces increases in costs that persist for years after the high prices have collapsed. In so far as business wishes to prevent a general increase in costs, it has an interest in avoiding a rise in prices.

A fairly substantial rise in wool, leather, linen and many imported articles is probably inevitable. A moderate advance in corn, hogs or wheat from the low levels of midsummer need not be disturbing. The danger of a broad spiral of price increases springs from the fact that, during ten years of depression, investment and replacements have been low,[1] and from the additional fact that the number of skilled workmen in the country is at least 13 per cent below 1930, and may be as much as 20 per cent below.[2] A sudden attempt by industry to catch up on replacements on a large scale would produce bottle necks, particularly if accompanied by large buying by belligerents and by our own army and navy. For example, a large simultaneous demand for light and heavy steel products may reveal a bottle neck in the blast furnace capacity of the steel industry. This capacity has declined from about 46.2 million tons in 1926 to 44.8 million in 1937. The railroads are another possible bottle neck. Although the freight car mileage per day in 1937 was 32.9 miles as against 30.4 miles in 1926, the aggregate capacity of all freight cars in 1937 was 19.1 per cent below 1926, and 18.6 per cent below 1929. Car shortages, especially of gondola cars, were barely escaped this fall.

The problem of avoiding bottle necks raises questions of great importance and interest. First of all, it indicates the

[1] During the nine years ending in 1939, expenditures on plant and equipment by private industry were 35.5 per cent below the nine years ending in 1929.

[2] In 1930, 5,955,000 persons were classified by the Census as skilled workers. Of these, 843,000 were fifty-five or more years of age in 1930, and may now with few exceptions be regarded as retired or dead. Of those under fifty-five years in 1930, approximately 406,000 have died, and an equal number or more have been promoted to foremanships or other supervisory positions or have gone into non-industrial occupations. A gross loss of 1,655,000 from the skilled force of 1930 is probably an understatement. The number of replacements is not known, but it is probably not more than half of the losses. Consequently, today there are probably not more than 5,100,000 skilled workers in all classifications.

need for a study of productive capacity and probable demand in order to discover possible danger spots. If the danger is foreseen, much can be done to prevent it. Second, it suggests the need for greatly expanding the training of skilled men. With the present supply of skilled men, probably not more than half of 8,500,000 unemployed can be absorbed by industry without creating many shortages of skilled workers that would start an upward spiral of costs and prices. Third, it indicates the importance of prompt contraction of government expenditures in some directions in order to offset expansion of expenditures on armaments. Fourth, it raises the question of the possibility of spreading our own rearmament program over a fairly long period of time. Here there may be conflict between military and economic considerations. Where speed is not imperative, it is important that armament expenditures be expanded gradually. On this point I am fearful that no one in authority will dare take the political risk of adequately representing our economic interests against the military. Fifth, the danger of bottle necks suggests that it may eventually be desirable to request foreign governments to limit their orders for some types of equipment. This obviously will depend partly upon our own armament requirements. Sixth, if by next summer the danger of bottle necks should be acute, it may be desirable to postpone changes in automobile models from 1940 to 1941. This would not only economize the supply of tool and die makers, but it would cause a postponement of a considerable amount of automobile buying for at least a year. Finally, if and when bottle necks should threaten at many points, the encouragement of restrictions on consumption would be indicated. The much-needed higher taxes on the middle income brackets would accomplish some limitation of consumption, but probably not much. A drive to expand the purchases of United States Savings Bonds by millions of wage-earners would be mildly helpful in case business expansion shows signs of producing a spiral of price increases. It would be particularly helpful if combined with a decision by the automobile industry to make no model changes in the fall of 1940 or 1941.

III

The activity induced by recovery, by the war, and by our armament is likely to induce movements for higher wages. These movements will be accentuated if there is an appreciable rise in the cost of living, but they will accompany increased business activity quite regardless of changes in living costs. There are about 4,000,000 workers in the country who are employed in plants where new unions are struggling to survive. Many of these new unions are having trouble collecting dues and are badly in need of an issue to increase the interest of their members and to attract new members. Consequently, the leaders will take advantage of any important gain in business activity to demand higher wages.

A substantial rise in costs would go far to defeat the efforts to prevent a substantial rise in prices. Furthermore, an advance in labor costs would carry over into the post-war period and would accentuate the problem of producing recovery from the post-war let-down. Mr. Keynes and his followers might deny this. According to Mr. Keynes, wage costs are related to incomes in such a way that higher wages raise incomes and commodity prices rather than limit production and employment.[3] But Mr. Keynes is thinking of a self-sufficient economy rather than a national economy competing in a world of other national economies.[4]

If high costs cannot be counted on to produce correspondingly high incomes, the problem of costs during a war and

[3] Strictly speaking, a rise in the price of labor, according to Mr. Keynes, is equivalent to a rise in the rate of interest and affects employment only by raising the rate of interest.

[4] I do not believe that Mr. Keynes's conclusion concerning the relationship between costs and income holds even in a self-sufficient economy. Certainly it does not hold under conditions as they actually exist. If one compares wage-income relationships between post-depression and pre-depression years (1926 and 1936, for example), one finds that wages had risen in manufacturing as much as 10 per cent and in other fields somewhat less, but that the income of employees had dropped from $49.3 billions to $41.9, or about 14 per cent. The explanation seems to be that the income of employees depends partly upon the volume of investment and that the volume of investment depends, among other things, upon the relationship between prices and costs. In 1936, with corporate profits 40 per cent below 1926, the total expenditures by industry on plant and equipment were nearly one third less than in 1926, and the net investment was 50 per cent less.

armament spurt raises important questions of public and managerial policy. Ever since 1933 it has been part of the public policy of the country to impose higher costs upon industry. This policy is reflected in the N. R. A., in the Walsh-Healey Bill, in the Social Security Act, in the Wagner Act, and the Wage-Hour law.[5] In formulating its policy toward costs today, the government needs to take account of two principal facts. One is that costs are already high relative to prices. This is indicated by a comparison of 1936 or 1937 with any year in the twenties. In 1937, for example, the gross income of the corporations of the country was almost the same as in 1926—$142.0 billions in 1937, and $142.1 in 1926—but corporate profits in 1937 were 42.3 per cent below 1926. In 1926, nearly three out of five (56.7 per cent) corporations made money, in 1937 only two out of five were in the black. Corporate profits in 1937, the most active year of the recovery, were over a billion below the year of depression, 1924. The second fact of which the government should take account is that American industry will probably be compelled in post-war years to compete with countries with substantially depreciated currencies. The British pound is now below $4 and will probably remain low after hostilities cease. It is true that the competitive power of Britain and other foreign countries may be limited after the war by lack of equipment, by high operating costs, and possibly by social unrest. Nevertheless, conservative policy requires the United States to assume that its ability to do business in large volume after the war will depend upon its success in offering goods at moderate prices.

In view of the high level of costs today and the uncertain currency situation, it is advisable for the government to throw its influence against increases in operating costs. This implies a sharp reversal of one of the major public policies of the last six years. Among other things, the problem of costs suggests the advisability of modifying the Wage-Hour law to make

[5] Until the winter of 1936 and the spring of 1937, it was also the policy of the government to raise the general price level. President Roosevelt's announcement in April 1937 may be taken as marking the abandonment of the price-raising policy except for selected groups of prices, such as agricultural products. The abandonment of the price-raising policy by the government was undoubtedly wise, but the government has been slow to see that the change in its policy toward prices required a change in its policy toward costs.

penalty overtime begin after forty-eight hours instead of forty-two. The decision on this point hinges upon whether the immediate determinant of wages is competition of employers for men or the pressure of workers for higher earnings. If the latter, the payment of penalty overtime will reduce the pressure for higher wage rates while permitting the men to make substantial increases in their earnings. This would indicate that the law should not be changed. If, on the other hand, it becomes evident that penalty overtime after forty-two hours is causing employers to raise their bids for labor, then the beginning of penalty overtime should obviously be raised to forty-eight hours.

Since wage rates advanced during the war will be reduced with great difficulty after the war, American business men will be wise to make wage concessions in the form of temporary adjustments which do not disturb permanent rates. Such arrangements were not attractive to trade unions in the last war. Nevertheless, they are sound in principle, because there is no reason why a temporary spurt in business should produce a large semi-permanent increase in wage costs.[6] The difficulties experienced by unions in the post-war wage adjustments of twenty years ago may make the older unions susceptible to proposals for temporary war bonuses based upon cost of living or profits. At any rate, it is important for employers to induce unions to review realistically their experience during the last war and to choose wage policies which will avoid a repetition of those difficulties.

The prospect that any spurt induced by war and armaments will be temporary creates the need for planning for the eventual drop in demand. After the World War a cushion was provided in the main by automobiles and housing. Although the production of cars dropped from 2,227,000 in 1920 to 1,682,000 in 1921, the low point was far above the 569,000 cars produced in 1914 and the 970,000 produced in 1915. In 1920, expenditures on housing dropped slightly to $1.66 billions from $1.74 billions in 1919. Even this was far above 1914. By 1921, expenditures on housing were nearly $2.0 billions and by 1922, $3.4 billions.

[6] The increase would not, of course, be "permanent" in most industries because improvements in technology would gradually reduce labor costs.

It is difficult to make plans for the post-war adjustment because no one knows now what kind of a world will emerge when hostilities cease. It is safe to assert, however, that the best protection against unforeseen changes and certainly the best protection against a sharp recession after a war spurt is the development of many new and cheap products. This means an ever greater expansion of industrial research. There is no reason why both automobiles and housing should not again be important cushions against a post-war drop. In the case of automobiles, the cushion could be created by postponing model changes. No change in the fall of 1940, for example, would cause a considerable postponement of demand until 1942. If, in the summer of 1941, a war boom were well under way and the end of the war were not in sight, a second postponement in model changes would shift considerable demand until 1943. If the industry could not be induced to postpone model changes, the government might employ the device of a temporary additional excise tax terminable at the end of the year. It is particularly important that the country be ready by the time of a post-war recession to spend large amounts on housing. Since the demand for housing appears to be elastic at the margin (probably because new housing is in competition with old) expenditures on housing will be increased by reductions in the selling prices. Cheaper housing is largely a matter of technological advance. However, there is danger that a war spurt will defeat the efforts of technology to cut housing costs. If expansion of employment produces a housing shortage in many cities and with it rising rents, building costs are likely to advance. This would be a calamity because it would materially reduce the possibility that housing would be an important cushion against a post-war and armament recession.

A war spurt is likely to weaken the technical position of business by inducing a rise in short-term indebtedness by consumers through the expansion of installment buying. The stability of our economy requires more violent fluctuations in the volume of savings—a larger rise as incomes increase and a sharper drop in savings as incomes decline. The spread of installment buying has done much to limit the tendency of fluctuations in savings to check fluctuations in income. This

is not an appropriate occasion to discuss the long-term aspects of this problem. If a war and armament boom develops, however, let the government and employers encourage employees to place a large part of their increased earnings into United States Savings Bonds. The well-sustained demand for housing and automobiles in 1921 was made possible in no small measure by the fact that small owners of Liberty Bonds liquidated their holdings to buy automobiles, houses and other goods. A substantial increase in the purchases of United States Savings Bonds by millions of workers during a war boom would be a substantial protection against a severe post-war recession.

Should the government plan to cushion the eventual decline in the form of deficit financing? A deficit will perhaps be unavoidable. The efficacy of deficits, however, seems to be small. They are useful in improving the immediate business situation, but a large deficit for a year or two has little effect upon the estimates of the earnings of capital over the long term. Hence it does little to raise the marginal efficiency of capital and to stimulate long-term production plans. This is an important and obvious point, but it seems to have escaped the attention of makers of fiscal policy. Furthermore, deficits which are so large as to convince business men that important new increases in taxes will eventually be necessary may actually reduce the marginal efficiency of capital and thus discourage investment. Consequently, if a deficit is used to cushion a post-war and armament decline, it should not be so large as to create the expectation that increases in taxes will be necessary in order to balance the budget. If this ideal cannot be achieved, the next best alternative would be to remove the uncertainty concerning tax changes by making them at the time the deficit is incurred but effective at a later date.

V

The recovery from the depression of 1929, except for a brief period in 1937, has rested only to a small extent upon an expansion of private investment, either by business enterprises or by individuals. Not until 1935, was there any net investment by private business and even in this year it was negligible. In 1936, with the national income at $62.6 billions, net investment by private business in plant and equipment was only $1.7 billions, or only 2.7 per cent of the national income. In 1937, expenditures on plant and equipment by private industry reached a fairly satisfactory level, but they represented, not true investment, but catching up on long deferred replacements in anticipation of price increases. Even more striking has been the low level of non-business private investment. During the nine years ending in 1929, expenditures on housing were almost half as large as expenditures by industry on plant and equipment; during the six years ending in 1938, they were less than one fifth as large. Whether or not we get a war boom, we are confronted with the long-run problem of substantially raising the propensity to invest both in industry and in residential building. This indeed is the very core of the recovery problem.

But would it be wise for the government today to encourage investment except at those points where there is danger of bottle necks? Would not a broad and substantial expansion of investment itself produce bottle necks, rising prices and costs? Does it make sense to suggest on the one hand that in the event of a boom we should be prepared to postpone automobile model changes for a year and on the other hand that the government encourage a general expansion of private investment?

The danger that general encouragement to investment will produce bottle necks is real. But perhaps the conflict between our desire to prevent a temporary boom and our desire to promote long-range recovery is not as great as it appears. Some deterrents to investment will not be easily or suddenly removed. Hence it is not too early to begin attacking them. Moreover, the temporary nature of the war and armament demand will make enterprises conservative about embarking on long-range programs. Consequently, considerable improvement can occur in the long-run investment outlook without producing an immediately dangerous jump in investment. Finally, the very prospect that the war will leave important new obstacles to investment (higher costs, competition with depreciated currencies, higher taxes for armaments) makes it prudent to remove every possible impediment to investment.

The government has based its policy largely upon the assumption that private investment has been held back by the

lack of consumer purchasing power. This seems to be an over-simplification. Of course, larger consumer purchasing power in itself would be desirable. The thing which stands out in the period of recovery, however, is the low capacity of increases in consumer purchasing power to induce investment —the low propensity to invest, if one cares to define the propensity to invest as the response of investment to a given change in consumer incomes. Compensation of employees may be accepted as a rough indicator of consumer incomes. In 1936, it was virtually as large as in 1923—$41.9 billions as against $42.3 billions in 1923. Nevertheless, the total expenditures by industry on plant and equipment in 1936 were 22.7 per cent below 1923. The drop in new investment in industrial plant and equipment was even greater.

The low propensity to invest is a result, not of a single cause, but of many. Some relate to very specific situations, such as the electrical utility industry. Of the general causes, timidity induced by the severe losses of the depression is probably the most important. Such timidity requires time to wear off. This time has been prolonged by the many new policies and conditions which business has needed to appraise and to which it has had to adjust itself. Until the end of 1934, investment was impeded by the fact that current demand was being met in part by substantial reductions in inventories. A deterrent that has received too little attention is the effect of the depression upon the numerous local capitalists of the country. These are the men who determine the birth rate of American business because it is they who supply a large part of the venturesome capital with which thousands of new enterprises are started each year.[7] Despite the repeal of prohibition which led to the establishment of many thousands of eating and drinking places in 1933 and 1934, the number of business births has been low compared with the early twenties. No one knows exactly what the depression did to the local

[7] Even in 1932, 338,000 non-agricultural enterprises were started. Nearly half of the new enterprises represent simply a change of name and ownership rather than the starting of an entirely new going concern. It is impossible, however, to draw a sharp line between new going concerns and changes of ownership because often the new ownership represents the addition of considerable capital to the business. The infant mortality is high also and the net increase is usually not large.

capitalists and the supply of venturesome funds because the local capital market is one of the unexplored parts of our economy. It seems plain, however, that the depression must have been particularly disastrous to the very part of the community upon which we most depend for enterprise and for willingness to back new concerns.[8]

Several of the above deterrents to investment have ceased or have greatly diminished in importance by the recovery, but others remain. One is the high level of costs which limits the ability of business men to discover attractive new investment opportunities. Even a high level of consumer demand may be a feeble stimulant of investment if business makes little money by satisfying it. Fortunately, technological progress can be relied upon to remove this obstacle. A second deterrent is the expectation that substantial increases in taxes will be necessary in order to provide the federal government with its needed revenues. This expectation reduces the marginal efficiency of capital and restricts investment. Finally, and most important of all, the propensity to invest has been kept low by the government's policy of encouraging the imposition of higher costs on industry. As I have indicated above, this was a major innovation in the public policy of the country. Despite the excellent record of the larger concerns in adjusting themselves to rapidly rising costs, business as a whole has not found the adjustment easy to make. During the first half of 1939, industrial production was almost exactly the same as during the first half of 1936—before the 1936-1937 boom. As a result of the cost increases of late 1936 and 1937, however, corporate profits in the first half of 1939 were 27.3 per cent below the first half of 1936.

It must be remembered that the great bulk of the business of this country is still done by concerns too small to employ specialized research staffs. Indeed, the 2,000,000 non-agricultural enterprises in the country have on the average only about 13.4 employees each. Even in manufacturing almost half of the workers are in small concerns with 250 or fewer employees each. Surely it is not surprising that many managers should be uncertain of their ability to invent cost-saving methods fast enough to meet the pressure for higher costs and that this uncertainty should lead them to prefer short-term to long-term production plans.[9] The low estimates of the marginal efficiency of capital have also led managements to use great ingenuity in order to avoid new investment or to reduce the necessary amount of new investment.[10] The propensity to invest will not be high until the government carefully reconsiders its policy toward costs in the light of industry's ability to meet higher costs and until business managers believe that they can embark upon long-range production plans without fear that through government and trade-union policy costs will increase faster than industry can meet them.

[8] The depression undoubtedly wiped out much of the capital of these men and also froze a large part of it in hotels, apartment houses, and other enterprises started in the late twenties.

VI

The restoration of full employment will require that over one fourth of the gross savings of the country be absorbed by the housing industry. Until 1936, the principal deterrent to investment in residential building was the large amount of distress housing on the market. In 1933, from one third to one half of the mortgage debt of the country was in default. Despite the fact that the government has refinanced $5 billions of distress home and farm mortgages, foreclosures since 1933 have totaled $5 billions.[11] The amount of foreclosed real estate held by mutual savings banks increased from $291 millions in 1933 to $683 millions in 1936, the high year. The index of mortgage foreclosures, which reached a high of 395 in 1933 (1926 = 100), dropped very little in the next two years. In 1934, it averaged 370, and in 1935, 366. Not until 1936 did it drop to 274. In 1937, it stood at 205, and in 1938, at 163. Expenditures on new housing actually dropped

[9] Note that managers usually have a choice between meeting current demand by using semi-obsolete high cost equipment or by purchasing up-to-date low cost equipment. The more doubtful they are of their ability to control the cost of operating the new equipment, the more disposed they are to avoid purchasing it for the time being by using old equipment.

[10] Of course managements are at all times attempting to do this, but the pressure has been unusually great during recent years because managements have been reluctant to seek new capital for enterprises when the existing rate of profit was low and the outlook for costs very uncertain.

[11] Twentieth Century Fund, *Debts and Recovery*, p. 249.

between 1933 and 1934. Even in 1935 it was only $533 millions, less than one-sixth the level of 1929, and scarcely one-ninth the level of 1926. It is significant that a sharp jump in expenditures for new housing accompanied the large drop in the foreclosure rate between 1935 and 1936.

Increasing the investment in housing is mainly a matter of raising the value of housing and keeping down its cost. The value of housing is limited by a tax rate which in 274 cities averaged $26.90 per thousand of true value in 1937. Translated into an income tax, this is roughly equivalent to a rate of 40 per cent. Translated into a sales tax it is equivalent to a 20 to 25 per cent sales tax on shelter. Sooner or later we must face the fact that by concentrating the burden of supporting local governments almost entirely on real estate we are seriously narrowing the most important single outlet for the savings of the community and thereby restricting the ability of our economy to give full employment.

Unfortunately the problem of building costs (which concretely is making possible the sale of a good five-room house for $2500 or less) cannot be simply turned over to the technologists to solve. The building industry lacks strong organizations which are interested in the price and the demand for the building as a whole. It is made up of numerous groups of producers who are interested in particular products, materials or services. Although the demand for housing under most market conditions seems to be elastic at the margin, the sellers of the various materials and services all assume that the demand for their particular products is inelastic, and they are probably correct. The assumption that the several components of building are inelastic in demand does no harm so long as competition prevails in their marketing. But in so far as the prices of building materials and labor are administered prices, they are set on the assumption that the demand is inelastic when, taking the building as a whole, it is elastic. This is why collective bargaining in the building industry has set wages with so little reference to market realities. A solution to the problem of costs in the building industry is not clear. The public, however, cannot indefinitely permit the prices which govern the largest single outlet for the community's savings to be administered on the assumption that the demand is inelastic when in fact the demand for the entire house is elastic.

VII

The conclusion of this analysis is that the fundamentals of the recovery problem have not been altered by the war. In its essentials, it remains what it was in midsummer—a problem of raising the propensity to invest, of increasing the capacity of a given increase in consumer incomes to generate increases in investment. Recovery up to now has possessed little cumulative force precisely because large gains in consumer incomes (produced by government spending, by the replenishment of inventories, and by the making of replacements) have stimulated so little expansion of investment.

But although the essentials of the problem of recovery remain unaltered, the war threatens to add formidable new obstacles to recovery. Certainly if one were today to estimate the prospective earnings of American industry over the next ten years, that estimate would be lower than the estimate one would have made last July. Such an estimate today might assume a year or two of earnings raised by war and armaments. But it would also have to take account of the probability of a substantial rise in costs that will persist for some time after the war, of the deflationary effect in the post-war world of depreciated foreign currencies and possibly of new restrictions on trade, of new tax burdens imposed by the expansion of our armaments. Furthermore, it would have to count as a probability the danger that a war spurt will substantially raise building costs and thus materially diminish the capacity of the building industry to contribute to recovery.

I do not assert that none of these dangers to recovery can be avoided or that nothing can be done about them. Indeed, it is just possible that they may turn out to be blessings in disguise. The very threat of new difficulties may greatly stimulate industrial research and it may be precisely what is needed to jolt the public into a willingness to face realities and to insist upon changes in conditions and policies that have long impeded investment. But the new threats to recovery are real and they will not be prevented or counteracted unless they are clearly seen and unless there is effective coöperation between managements, organized labor and the government to combat them.

Remarks

Dr. Burgess: Thank you, Dr. Slichter! In this conspectus of the recovery problem, Professor Slichter has referred at a number of points to federal financing and its effect on national economy.

No matter how often I see face to face the next speaker, his voice will be most familiar to me over the telephone, as a result of a number of months' experience when he was Under Secretary of the Treasury and I was on the obeying end of the telephone. It was a very reasonable voice over the telephone, and since then his voice in public utterance has been one of reason and persuasiveness. We are glad to have Mr. Arthur A. Ballantine, former Under Secretary of the Treasury, now a prominent New York attorney, speak to us on the subject of "Employment and Federal Finance".

Mr. Ballantine: The voice of Dr. Burgess over the telephone, with which I am so familiar, was not always an entirely meek voice, and it was not at all infrequent that the suggestion of what we would do originated on the New York end of that telephone and not on the Washington end. There is no time when Dr. Burgess is without ideas as to the proper course which should be pursued.

I am really here in the capacity of a substitute for the good friend of us all, Lewis Douglas, who planned to come but was unable to do so. I hope that my experience will not be like that of another substitute whom I once encountered in the little town in Ohio where I grew up. There was to be a church sociable, that being one of our leading forms of entertainment, and it was to begin with a clarinet solo. Unfortunately, the clarinetist was not there but the clarinet was there. A very kind gentleman from the audience said that he would take it on. He played *My Old Kentucky Home*. As he played he noticed a gentleman in the front row who seemed to be greatly affected. He played with more and more feeling, and tears came to the eyes of the man in the front row. The player had never had such a tribute, and after his solo was over he was deeply moved to see how his playing had affected this man. He said, "Are you by any chance a Kentuckian?" The answer was, "No, I am a clarinetist." (Laughter)

(Mr. Ballantine then read his formal paper.—Ed.)

EMPLOYMENT AND FEDERAL FINANCE

ARTHUR A. BALLANTINE
Former Under Secretary of the Treasury

A STRIKING fact about employment in the United States today is that the federal government itself has become the largest employer. The number of employees on the civil list, standing at 940,000, has passed the peak reached in the Great War and is approaching the million mark. Yet that new total represents but part; in payrolls financed by the Public Works Administration, the Civilian Conservation Corps, the National Youth Administration, and particularly the W.P.A., we find perhaps three and a half millions more deriving employment from government activities, exclusive of the army and navy, also of the farmers receiving benefit payments.

These impressive figures are to be considered in relation to a total reported employment for September of a little under forty-six millions, out of a total available force estimated at somewhat under fifty-five millions. The estimate for the unemployed thus stands at somewhat under nine millions, a figure necessarily including unemployables.

At the moment private employment has been on the increase, with an estimated 700,000 factory workers returned to private jobs from July to mid-October. Yet the securing of adequate employment, and fuller and more assured employment at adequate wages, remains our most crucial domestic concern.

It is widely urged that the only really long-range hope for better employment lies in the expansion of government employment activities. Growth in these activities came about as a depression-born emergency policy; continued expansion is now urged as an essential permanent policy. Such a policy presents problems going to the very roots of government finance, and indeed of our whole economic structure.

What would have been formerly regarded as a barrier to the continued expansion of government employment is the fact that current revenues fall far short of paying the current costs. Today, however, in many quarters, objections to continued deficits are met with disdain, if not with derision. It is said that we are in a new era of public finance, and that the idea of budget balancing is both benighted and inhuman.

The question presented is of vast scope and in this brief paper I propose merely to sketch a few considerations making for a hardy belief that the best hope for employment, as for the Treasury, lies, not along the line of government expansion, but in applying those policies which will most foster private employment.

The dominant thought of the government expansionists is that private enterprise has not been in a mere "slump", but has become permanently unable to furnish adequate employment. That view was set forth for example by Seven Harvard and Tufts Economists in *An Economic Program for American Democracy*. They began their statement with the declaration: "The economic development of America may be divided into two periods. The first . . . was the period of economic expansion. It came to a dramatic close with the collapse of 1929. The second period has so far been one of economic stagnation." These economists go on to express the belief that without continued government deficit spending on a large scale this post-1929 period will continue to be one of stagnation. They point to the disappearance of the territorial frontier, the slowing down in the rate of growth of the population, and the "maturity" of development of resources and industry, and see little, if any, prospect for major new industries. They conclude that opportunity can no longer be furnished by private enterprise for the adequate investment of savings in capital products, essential to full employment. That function, in their judgment, must now be performed largely by the government. They ascribe the increase in the national income during the post-1929 period almost entirely to the government deficit spending.

The view of these younger economists is proclaimed, at least in part, by John Maynard Keynes, whose views are perhaps more widely accepted here than in his native England, and is earnestly expressed by certain magazine writers of the day. "If private citizens won't or can't spend, the government

must" is the thesis. It is usually combined with the view that government taxation should be largely directed toward taking over the income that individuals might save and directing it into consumption.

Any suggestion that by this policy of continued government spending a dangerous debt is created is now countered with the proposition that the federal government accounting method is out of date: that if the government, like a business, maintained a capital balance sheet, it would appear that a large part of its spending creates assets fairly to be treated as offsets to the debt.

Hopes are also expressed by some of the advocates of spending that government tax revenues can be largely increased, particularly by better enforcement of the income tax and by higher rates, especially in the middle income brackets. These proposals seem rather inconsistent with the general thesis, as the real virtue in the new policy is supposed to rest in having the government continuously spend more than it takes in from taxation.

These novel theories of the rôle of the federal government in employment and in finance have advanced from the classroom, from the pages of the magazine and pamphlet, into the actual practice of our federal government. Today our government operates on the basis of an indefinite continuance of what were hitherto regarded as vast deficits, calling for elimination at the earliest possible moment. What the government is to supply is not pump-priming but a permanent additional pump.

It will be readily conceded that today the problem "cannot be settled out of hand by invoking general formulas, however hallowed." It is worth while to refresh our thoughts as to the dangers which may be involved in the new concepts. I wish to focus the discussion here on only two points.

First, continued deficit financing by the government still carries danger to employment through threat of ultimate financial disorganization. So far as I have observed, spending advocates usually say very little about the real state of the federal finances—of such concern in the operation of the Treasury—contenting themselves with general observations. They even appear guilty of omitting facts material for appraisal of the facts that are stated.

Federal expenditures are now running at the annual rate of over nine billions and exceed current revenues by upwards of three and a half billions. This is without allowing for further increased expenditures on national defense. Current expenditures are almost three times the average for the years 1922 to 1931. The deficit alone exceeds the average annual expenditure of those years. Deficit spending in the past nine years has run the federal direct debt up to over forty-one billions—more than two and a half times the post-war low of 1930—with an increasing contingent liability on government guaranteed debt, now exceeding five billions.

The important point is not the amount of the debt today, but the trend—the fact that government expenditures have been lifted to a point at which there is no prospect that revenues will catch up except through a very large expansion of the national income. Such an expansion will at the best take time.

It must also be borne in mind that, through various increases in taxes and through higher business activity, federal revenues have been pushed up to the almost unprecedented figure of five and a half billions, and this without closing the great gap. Moreover, no recognized student of taxation has offered any practical plan of increases in taxes which would close the gap. There are, of course, grounds for expecting an improved Treasury showing, due to the recent rise in business activity, but the net effect on the budget still remains somewhat problematical.

Is this government debt, so rapidly mounting, rightly to be regarded as a source of anxiety? Some indication of this appeared in the recent votes on bond issues and spending plans.

Net recoverable assets held by the Treasury, other than the stabilization fund, have been listed at something over three billions, yet how far they will be actually converted into cash is uncertain. Up to the present time the proceeds from the liquidation of such assets have simply been thrown into the stream of expenditure. On federal public works, roads, conservation work, new construction projects, and the like, some thirteen billions are reported to have been expended from 1931 to 1940. The difficulty with treating these projects as assets in the financial sense is that unlike true business assets they do not, through receipts for charges, actually or ultimately turn

into cash. Their beneficial economic effect is at best only indirect. Many of them, indeed, far from being sources of revenue are souces of increased annual expense.

It is sometimes asserted today that the government debt need never be paid. It is of course true that the debt does not have to be paid at a given moment, for only parts of it come due at intervals, and these may be refunded. Yet it remains absolutely essential that belief be maintained in the ability of the government to handle its debt and ultimately to meet at least carrying charges out of income.

Notwithstanding all reassuring suggestions as to the debt, certain facts stand out. A vast public debt would be a millstone about the neck of the government in another great emergency, such as a foreign war. Such an emergency we confidently believe we shall not have to meet, but our present financial unpreparedness because of the debt, and our already high level of expenditure and taxation, are all too obvious.

Moreover, a swollen and steadily growing government debt carries in itself the threat of creating a serious emergency. Government credit is unimpaired under the conditions of today. Yet, if the idea should ever take root that the debt is too great or unmanageable, we would have to face the possibility of a flight from the currency such as worked disaster in Germany and prepared the way for the Hitler régime. Suggestions that the government might prevent any such panic by taking over the banks, prohibiting exports of capital, and the like, are no answer. Such drastic expedients would only accentuate the trouble.

The second point which I wish to suggest here is that, apart from its threat of potential financial disaster, continued deficit financing makes against the building up of a maximum of private employment. Use of the drug of expenditure tends to prevent or postpone the use of the steps needed to restore economic health.

Unless the government is to take over and operate industry—which is another proposition altogether—it is clear that the largest hope for employment rests with private enterprise, where the bulk of employment still is today. Indeed, the support of the government itself, in all its humanitarian activities, rests upon production of industry. What the government directly creates to pay its own bills is insignificant.

If, like the seven economists quoted, we must abandon all hope for the vitality and expansive power of private enterprise in this country, we need not be concerned about conditions for its growth. Before accepting such unwelcome conclusions, however, we should examine the opinions of other and perhaps more mature thinkers.

Turning from the academic chair to the views from industry, we are told that billions of dollars of investment are actually needed to bring our industrial, railroad and utility plants up to the point of supplying the needs of our people. We are told that the very fact that the incomes for much the greater part of our people are so low indicates the additional production which is necessary. We have assurance as to the great need of further industrial development from so impartial an authority as the Brookings Institution.

The theory that a slower rate of increase in the population tends to check employment is countered with the proposition that if we have less work to do to supply the bare necessities, we shall have more to do for the embellishments of life. The idea that the absence of a territorial frontier to conquer means less work is met with the proposition that technological progress, potentially without limit, may vastly increase our economic wants and work.

On the future outlook for industry and the economic system, the articles by Professor Sumner H. Slichter, in the current *Atlantic Monthly,* and by Professor Willford I. King, in the *Journal of Political Economy* for October, furnish wholesome offset to the pessimism of the spending school. These recognized students seem to make it clear that no one, however confident, is truly capable of writing "finis" to the possibilities of industrial expansion in America or to the realization of larger national income and employment. Perhaps the doleful predictions of the new spenders are likely to be no better vindicated than those made in every crisis in the past.

It has not even been demonstrated that the recovery in national income, such as there has been, was due to government deficit spending. It is by no means sufficient to point to the fact of deficit spending, and the fact of recovery of national income, and assume that the spending was the cause of the recovery. No one can seriously doubt but that there would have been substantial recovery without that deficit spending.

The sharpest recovery until recently was that in 1933, before deficit spending on a large scale got under way. The present acceleration of the pace of industrial activity does not find its roots in an increase in deficit spending.

If we can still retain hope in private enterprise, it is obvious that renewed application of the expedient of deficit spending is likely to retard the establishment of the most favorable conditions for industrial progress. An illustration may suffice to indicate the thought.

In the spring of 1937 there began a well-remembered sharp industrial recession. The view of the spenders is that the 1937 recession was due mainly, if not wholly, to a lessening of deficit expenditure. With the completion of the bonus payment, the beginning of the social security taxes, and some reduction in relief, the cash operations of the Treasury for a brief time aproached a balance. This momentary balance is said to have been fatal to economic recovery. The theory thus admits one danger of relying upon excess government expenditure, but the real danger lies deeper.

As we all know, many other factors, deserving the utmost attention, underlay the 1937 recession. Notably, there was the breaking out of the sit-down strikes, perhaps fostered in part by certain government policies, with their adverse effect upon production. Rapid increases in wage rates during the latter part of 1936, beyond increases in production, undoubtedly tended to throw the price structure out of balance in some lines. There was an increase in bank reserve requirements and the partial sterilization of gold, later abandoned. There was the operation of new taxes. And it is not to be forgotten that the attention of Congress and the country was largely concentrated on the Supreme Court measure rather than upon the solution of pressing economic problems.

The proposal made soon thereafter of renewed deficit spending was calculated to divert thought from dealing with those difficult underlying factors. Falling back upon spending will always tend to effect such diversion of attention.

What are the governmental policies that would make for helpful and healing expansion of industry? When this question is raised, it is frequently suggested that what is desired is merely a return to laissez faire with all its deficiencies.

To say that the only alternatives are between laissez faire and continued deficit spending seems wholly to misrepresent the issue. It is recognized on all sides that government function has enlarged, that well-considered government regulation is more necessary than it was a generation, or even a decade, ago. The issue today is not whether the government should stop governing, but whether its task should be confined mainly to governing, and its policies directed to the upbuilding of industry capable of standing on its own feet and supporting our people and the government. Official recognition of such a policy would vastly encourage industry.

Such a recognition is a matter of both measures and atmosphere. It has been said:

> economic prosperity is excessively dependent on a political and social atmosphere which is congenial to the average business man.
>
> It is the return of confidence which is so insusceptible to control in an economy of individualistic capitalism. This is the aspect of the slump which banks and business men have been right in emphasizing and which economists who have put their faith in purely monetary measures have underestimated.

These are declarations, not of the U. S. Chamber of Commerce, but of John Maynard Keynes, perhaps the patron saint of the spenders.

I would like to leave these thoughts: No one can really demonstrate that in the United States the system of private enterprise has lost its vitality or is incapable of large expansion. Given opportunity, its resourcefulness and forward urge are still our best hope. Substitution of government activity and legislative and administrative decisions is far more likely to mean stagnation and lessened production.

The policy of continued deficit spending, far from promoting private industry and employment, in the long run threatens them directly through potential financial disorder, and threatens them indirectly through minimizing and obscuring the need and possibility of economic solutions within the framework of self-sustaining private enterprise.

May we substitute hope for gloom and, abandoning the imagined magic of continued deficits, forge ahead on those forces which made our industrial development and standard of living the envy of the world.

Remarks by the Chairman

Dr. Burgess: Thank you, Mr. Ballantine!

It seems appropriate now to continue to take up points which Dr. Slichter covered in his general summary. One such point is the problem of labor policy in its relation to the volume of employment. I am tempted to indulge in biographical reminiscences. Mr. Ballantine has described the theory of stagnation which has dominated no small sector of economic theorizing today. By implication, he has suggested that those who support this theory of stagnation have relied considerably on experiences bounded by the year 1929 on the one hand and the present year on the other, a period in which stagnation was, of course, a dominant characteristic of the economic situation. The recent experience of war and its effect on our economy suggest that we need to consult advisers whose experience dates back somewhat further. The next speaker is such a person. During the Great War, he occupied a position of importance in Washington. During the period of prosperity he held positions in public and private enterprise, and in the depression he has served in various important capacities. Behind that, he has been a student, a professor at Columbia University, a member of the Staff of the National Bureau of Economic Research and, above all, a Trustee of the Academy of Political Science. Dr. Leo Wolman!

LABOR POLICY AND THE VOLUME OF EMPLOYMENT

LEO WOLMAN
Professor of Economics, Columbia University
Trustee of The Academy of Political Science

THE labor policy of a country is a collection of customs, laws, and administrative practices and interpretations. Such policy affects the present and future course of business and, hence, of employment by creating favorable or unfavorable conditions of costs and of labor relations and by inspiring confidence or misgivings concerning the behavior of these critical elements of the labor situation in the future. A gradual change in labor policy may well be absorbed without undue difficulty or strain; an abrupt change is apt to throw things generally out of gear and require a long time to digest. It is characteristic of post-war changes in labor policy that they have been nearly everywhere swift and thoroughgoing.

In the United States since 1933—or perhaps since 1930—traditional labor policy has been completely overhauled. In the process influences of the market and the state of business have become subordinated to rules and regulations, embodied in laws, decisions of courts and boards, and the guiding principles of multifarious administrative agencies. In so far as these rules and regulations have become effective, they have been reflected in the developments of wages and working conditions, the methods of labor relations, and of relief and social security. And it is in these areas that the clues to the relation of labor policy to unemployment must be sought.

Historically and logically improvement in wages and working conditions were associated with good business and increasing production. No one had ever supposed that they could be raised by mandate, in the absence of conditions capable of sustaining them at their higher levels. Our present labor policy is based on precisely that supposition. For that reason the current emphasis is mainly, if not exclusively, on nominal

standards of wages and hours. It is these standards that are raised by the Fair Labor Standards Act, the Walsh-Healey Act, and collective agreements between employers and unions. It was for the purpose of raising these standards that laws, fixing wages and hours or empowering specified agencies to fix them, were enacted; and it was for the same purpose that laws encouraging the organization of labor and the use of collective bargaining were likewise adopted. For the preamble of the Wagner Act states that " the inequality of bargaining power between employees . . . and employers . . . tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage-earners in industry . . . ."

The immediate goal of our labor policy, as it relates to wages and working conditions, is, therefore, to improve nominal standards in order that the purchasing power of labor, both employment and payrolls, should simultaneously expand. That this policy has been wholeheartedly and persistently applied is a matter of record. Although many of these laws and regulations have been effective for less than five years, they have virtually revolutionized the structure of American wages and radically changed the relation of wages to employment, payrolls, and the volume of business activity and profits. One measure of this change is found in the course of wages and hours during the last quarter-century. In five industries, for which there is a more or less adequate, continuous record and which employ from one fourth to one third of the total working population of the country, the rate of wages has tripled from 1914 to 1939. The purchasing power of these rates doubled during the same period. In the largest of the five industries, the normal work-week declined by 15 hours, or by approximately two 8-hour days. And in the two smallest industries, the normal work-week was reduced by about 20 hours, or two and one-half 8-hour days. A large part of these advances, moreover, was made during the few years since 1933.

These are familiar facts. Equally familiar is the fact that the anticipated increases in employment and payrolls, that were expected to accompany or follow these phenomenal adjustments in wages and hours, have so far failed to materialize.

Indeed, even the reduced quota of maximum hours has rarely been reached by those who work and the number at work has notably failed to keep pace with the growth in population or even to approximate earlier trends in the expansion of employment.

However serious a problem of economic adjustment recent movements in wages and hours may have already created, their greatest significance is to be found in their future course. For a business system often operates under unfavorable conditions, and it is the function of owners and managers to employ their knowledge and resourcefulness in surmounting them. But if the forces with which they are constrained to deal prove powerful and intractable and are supported by policies which are themselves inflexible and unyielding, then the task of adjusting the policies of business to the policies of government may well become increasingly difficult and prohibitively expensive.

Current American labor policy is a many-sided experiment. Among its many component parts, the measures concerned directly with fixing wages and hours are secondary to the measures professedly directed toward elevating the practices of labor relations and promoting more democratic management of industry. Our wage and hour laws touch only a small fraction of our employed population and the standards they establish are more or less fixed by law. But the National Labor Relations Act, and its local counterparts, have well-nigh universal application and the guiding principles by which they are administered are vague and confused, and, hence, subject to frequent changes in interpretation. If we wish to gauge the future trend of labor conditions in this country, it is with this law that we should begin. For it is at this point in our national labor policy that the most far-reaching steps are being taken and it is here, consequently, that the direction and intensity of the various labor trends are being most effectively determined.

The Act itself is, of course, a comprehensive measure and all of its provisions touch the present position and future prospects of business. But I propose to consider only those features of this law and its administration which most obviously are calculated to affect the cost of doing business and bear most directly on industry's calculations for the future.

The most important criterion that should be applied to any piece of legislation or policy, that undertakes to regulate the conduct of labor relations, is whether or not it increases or diminishes the sense of responsibility of the several parties to such arrangements. To the extent to which a law governing industrial relations tends to make men or agencies less responsible than they would otherwise be, it will inevitably multiply the occasions for dissension, undermine the requisite discipline of industry, and reduce the chances for the peaceful and uninterrupted operation of shops and factories.

During the brief history of the National Labor Relations Act much has already been done to weaken responsible action in industrial relations. The most far-reaching steps in this direction have been associated with changes in the right to strike as provided by the terms of the Act and as interpreted by the Labor Relations Board. The right to strike under prevailing arrangements has been so liberalized that the ordinary inhibitions against striking are tending to become virtually ineffectual. The Board itself has seen fit to submit this right to practically no limitations. Indeed, the Board has exhibited such zeal in conferring what it regards as the benefits of organization and collective bargaining that it has shown little concern with the methods whereby the strength of organization is acquired and employed.

Until recently the whole issue was allowed to pass unnoticed by the courts as well. In the Fansteel case, however, the United States Supreme Court took a long step toward modifying these rights by holding that "the employees had the right to strike but they had no license to commit acts of violence or to seize their employer's plant." But in the latest decision dealing with a similar point, a lower federal court, apparently following the lead of the Board, felt obliged to draw distinctions among various forms of violence and explained that "Some disorder is unfortunately quite usual in any extensive or long drawn out strike. A strike is essentially a battle waged with economic weapons. Engaged in it are human beings whose feelings are stirred to the depths. Rising passions call forth hot words. Hot words lead to blows on the picket line. The transformation from economic to physical combat . . . is difficult to prevent. . . . Violence of this nature, however, much it is to be regretted, must have been in the contemplation of the Congress when it provided in Section 13 of the Act that nothing therein should be construed so as to interfere with or impede or diminish in any way the right to strike. If this were not so the rights afforded to employees by the Act would be indeed illusory." It is easy to see how the acceptance of this view may well restore the right to strike to the position it occupied before the Fansteel decision.

The practical significance of this trend in the definition of the right to strike cannot be too strongly stressed. It introduces additional and grave uncertainties into the whole outlook for industrial peace; for once either party to a labor bargain deems it unnecessary to weigh the alternative costs of proceeding with negotiations or inviting a break, the chances for amicable settlement are materially reduced. The existence of what appears as a reasonably safe opportunity to resort to force is calculated shortly to impair the whole process of negotiating and bargaining. At the best the accepted procedures of labor relations require delicate and intelligent handling. Choice of the issues which are to be raised in negotiations and the terms on which a settlement can be made are themselves problems that can be solved only by the most responsible of men. But where the representatives of either party believe that their hands have been strengthened by new rights and privileges, the possibility of settlement on reasonable terms will become more remote.

Another point at which the Labor Relations Act threatens in the long run to exert a disruptive influence on industrial operations and add materially to the costs of doing business is in the changes it is effecting in the position of supervisory employees. On this matter, as on many others, the Board has apparently not yet made up its mind and alternately blows hot and cold. In a long line of decisions the attachment of the foreman to his employer is firmly established and foremen are prohibited from voting in elections for the choice of bargaining representatives. In other decisions foremen are granted the same rights to organize and bargain as their subordinates possess. Presumably they may join established unions composed of employees whom they supervise. They have formed separate unions, affiliated with the C. I. O. or

A. F. of L., as the case may be. It was once the custom in this country for most unions to exclude foremen from membership. But in these days of heavy organizing and heavy bargaining, when the strategic value of foremen and supervisors to a union is readily perceived, the custom is being rapidly discarded. It requires no great insight into the behavior of management to foresee what problems of shop discipline and the exercise of authority these new arrangements will create; and, indeed, there are already indications in some industries of the appearance of serious problems growing out of such developments.

The least that can be asked of any systematic program of labor relations is that it establish and maintain comparatively stable conditions. Here again the adjudications of the Labor Relations Board pertaining to the appropriate bargaining units—whether craft or industry, employer or plant, region or locality—have already been featured by vacillation and instability that promise to be even greater in the years to come. It may fairly be said that, in the absence of the promises and hopes which the Act and the decisions under it have held out to new and rival labor organizations, the conflict between the C. I. O. and the A. F. of L. might never have occurred. But once such wars break out, they are hard to stop and their existence remains a perpetual threat to peace in industry. It is true, of course, that as this country approaches the period of another presidential campaign, the political necessity for peace between the two warring factions in organized labor will become more pressing and every available political expedient will be employed to bring it about. But it is not clear how the issues created by four years of warfare and litigation can be swiftly and satisfactorily composed and how, then, American business can look forward to a period free from strikes caused by conflicting jurisdictions and ambitions within organized labor itself.

The probable economic effects of these elements of our labor policy appear to me quite plain. They do not promise an era of peace, quiet and stability. In so far as the movement toward the more complete organization of labor, so strongly encouraged by many agencies of the government, is realized, it will be followed by a progressive relaxation of discipline, more numerous and subtle restrictive practices, advancing wages and costs, and general wage-fixing. In some cases the control of wages and output will be exercised by the unions themselves; in others, by unions in combination with employers; and in still others, by unions, employers and the government. But in any case the outcome is bound to be a state of monopoly, or of joint labor-industrial cartels, acting as such combinations usually do—limiting production, setting excessively high wages and high prices, and reducing the opportunities for employment.

There remains a third set of factors in labor policy which will play no small part in transforming the relations of employers and employees and bringing wages and working conditions under a greater measure of control. The first of these is the system of federal relief begun in 1933 and the second the national system of social insurance established in 1935. Both have already powerfully influenced the course of things in the American labor market and, if the policies they follow are unchanged, they will remain a strong influence for some time to come. The scales of wages and schedules of hours which set the standards of labor on our works' relief projects profoundly affected the general movement of wages in this country and did much in the strategic construction industry to sustain inflated rates of wages of building tradesmen whose jobs on work relief were for a lengthy and critical period almost their sole source of employment.

Among the several parts of our social security system the policies which guide the administration of unemployment insurance are likely in the long run to touch the labor market most vitally and most directly. For any plan of unemployment insurance must at once undertake to define unemployment and establish the conditions under which benefits can and will be paid. It has proved characteristic of all systems of compulsory unemployment insurance that they have shortly become the arbiters of wages and working conditions as well as the distributors of unemployment benefits. In this respect we are following broadly the precedents that rule these matters in foreign countries and we are engaged daily in setting forth the principles that will assist us in defining such concepts as voluntary and suitable employment. While the American ex-

periment in social insurance is still young, it is already embarked on policies and practices that tend to shift the responsibility for finding a job and to impede the mobility of labor. As the authors of a report[1] to the Social Security Board have observed: "Nothing in the unemployment compensation laws renders the worker primarily responsible for seeking work, and his benefits may not be withheld if he fails to do so."

These observations suggest the trends in labor relations and labor standards in the years that lie ahead. They are more likely than not to become stronger with the passage of time. The forces they reflect are at work in an economic system in which the rate of unemployment during the last peak year of business activity, 1937, was not far from 15 per cent. Barring the effects of extraordinary and temporary influences, such as are associated with war, there would seem to be no good reason to anticipate a material reduction in this rate of unemployment as long as our labor policies continue in their present course. For it is these labor policies that account for much of our hesitancy in business recovery and in reëmployment.

[1] *Principles Underlying Disqualifications for Benefits in Unemployment Compensation*, Social Security Board, August 1939, Part I, p. 19.

Remarks by the Chairman

Dr. Burgess: Thank you, Dr. Wolman!

We turn again to a specific phase of the general question which has been alluded to in some of the speeches to this point, and that is the question of "The Influence of War on Prices". Lionel D. Edie was for some years a professor at the University of Chicago. He is a writer of books, that many of you know, on general economics and on money. He has lately been an adviser to business men and financial concerns on the state of business and where it is going. Dr. Edie!

THE INFLUENCE OF WAR ON PRICES

LIONEL D. EDIE
President, Lionel D. Edie and Co., Inc.

THE history of price fluctuations under war-time conditions shows that major wars are associated with inflationary advances of commodity price averages. In popular discussion, one often hears the blunt, brief assertion: " War means inflation." Historical study and statistical research provide confirmation of the popular notion.

Although this general observation is the logical point at which to start discussion of the subject of war and prices, nevertheless the discussion itself must seek more precise and definite forms. What we really need is a method of analysis which will answer the questions: What degree of inflation are we to expect in this particular war? What forms will it take?

Out of the experience of the past the economist seeks an apparatus of thought and a mode of approach calculated to throw light on the connecting links between war and prices. What are the activities of a war situation which have price significance? To what extent can these be subjected to quantitative measurement?

At the outset, I shall endeavor to outline the apparatus of thought which has evolved through the economic literature of many war periods. This outline may be stated as follows:

1. War brings stresses and strains on a country's balance of payments and money markets, which the government seeks to control by changing the status of gold in such a way as to weaken and impair the ordinary functions of gold. This process has taken many different forms and has received many names, such as debasement of the coin, suspension of specie payments, abandoning the gold standard, pegging the rate of exchange, creating a blocked currency.
2. In conjunction with this change in the status of gold there occurs a depreciation of the belligerent country's

currency in the foreign exchanges, relative to the more stable monetary units of countries not engaged in the war. If this depreciation in the foreign exchanges is artificially held in check during actual hostilities, it breaks out in full force in the post-war period.
3. In order to finance the costs of war, the belligerent country resorts to taxation and to borrowing The proportion of total cost met by each method varies widely from war to war and from country to country but, in general, the greater the proportion of war costs met by borrowing, the greater the inflationary influence of fiscal policy.
4. As a result of war-time fiscal policy, there occurs an increase in the quantity of money in circulation, either in the form of note issue or of bank deposits or of both. This increase in the quantity of money is not matched by a corresponding gain in volume of production and trade, and the equation of exchange is given an inflationary bias.
5. The belligerent country modifies the rate of consumption of commodities. It requires the civilian population to give up normal consumption of non-essentials and of war materials and, on the other hand, it greatly increases the consumption of goods for the military purpose of destruction of the wealth of the enemy. Self-denial by the mass of the people is a great internal resource which the government taps, but this self-denial cannot fully offset the increased consumption of the military machine. There is a net increase of consumption, and the size of this net increase is a determining factor on the demand side of the price-making process.
6. From the supply side, war withdraws man power from the factories and the fields until unemployment disappears and labor shortage ensues. Simultaneously, certain raw materials are limited in supply and bottle necks in supply of vital materials develop. When the exhaustion point on labor supply and vital materials is approached, prices receive their greatest stimulation.
7. In order to defer this exhaustion point as long as possible, belligerents buy materials from neutral countries and thus generate an abnormal world-wide demand for

commodities. They pay by borrowing when they can, and, when they cannot, by realizing cash from mobilizing the foreign assets of their nationals and from shipping gold. The more they borrow from abroad, the more do they provide a world stimulation to prices.

8. Under these pressures, war produces dislocations as between groups of prices. Some groups go up much faster than others and dispersions and maladjustments develop. In particular, cost of living tends to go up ahead of wages and real wages tend to decline. In the post-war period, this process is often reversed.
9. Governments seize upon these price fluctuations as an opportunity for a flood of political regulations. Politicians accuse business of profiteering. They resort to price-fixing, rationing, taxing excess profits and publicity on price advances. They try to hold the lid down, but inasmuch as they are all the time expanding the monetary pressure upward, the total effect of all these interventions on the general price level is not great. Their main effect is not on the general level of prices but on the relations between individual prices. They cannot hold the general price level down if monetary policy is such as to push the level up.

This series of nine points provides the pattern for analyzing the effects of war on prices. To summarize, the pattern consists of change in the status of gold, depreciation of currency in foreign exchanges, fiscal policy which emphasizes borrowing, increase of the quantity of money, increase of consumption of war essentials, approach to supply exhaustion points in labor and in vital raw materials, placement of war orders abroad, dislocation of relationships between groups of prices, and political intervention to curb and control individual prices.

This apparatus of thought is what we learn from history and from the labors of many generations of economists. The further task is to endeavor to apply it to the present war situation. This war is different, as all wars are different. This does not mean that the principles derived from the past are inapplicable, but does require their adaptation to the peculiarities of the present situation.

In order to make the analysis as concrete and as practical as possible, I believe it is best to state the problem as follows: Is the present war likely to be as inflationary as the great World War?

Twenty-five years ago, the principal European belligerents suspended specie payments, embargoed gold exports and abandoned the gold standard. Great Britain, France and Germany cannot repeat this step because they were not on the gold standard at the start of the present war. The United States remained on gold throughout the World War, but by inaugurating the Federal Reserve System, with its liberalized reserve provision, this country gave its banking system an inflationary bias almost equal to that of the British banking system which was off gold.

The World War started an era of competitive currency depreciation, devaluation and managed currency. Experience with these devices over a quarter of a century has brought disillusionment in many respects and a revulsion of public sentiment against what Adam Smith in the eighteenth century called these ancient juggling tricks to defraud the people. Currency warfare is of such recent and unpleasant memory that a certain immunity to repetition of that course may be assumed. We are less likely to be put through these paces again because we have seen their evil side during the past two decades. The financial hangover from yesterday's debauch is a safeguard against fresh return to the bottle.

The chief effect of this war on gold is likely to be the extreme concentration of the metal in the United States. As the concentration continues, it promises to bring the gold position of the United States to a final *reductio ad absurdum.* To pay more than $35 an ounce for additional metal when our economy is already oversupplied does not seem probable.

The mounting stock of gold and the increasing excess reserves do contain potentialities of inflation, but as long as the surplus funds are idle and inactive they represent only potentialities. Under an Administration which does not fully cultivate the confidence factor in business and finance, the pyramiding of loans and deposits on the basis of the excess reserves takes place slowly if at all. Consequently, the potential expansion does not tend to become actual. If some future Administration takes a more constructive attitude toward the confidence factor, the situation could conceivably become inflationary as a result of expansion of loans and deposits. Under present conditions, runaway commercial credit expansion is theoretically possible but practically improbable.

Thus, although on the surface the gold surplus appears to be highly inflationary, nevertheless in practice it is not necessarily so under present political conditions. There is nothing inherent in the gold situation which compels as drastic a rise of prices as occurred in the last war.

The foreign exchange situation may be studied in terms of the relation between the pound and the dollar. After a temporary period of fluctuation in the last war the pound was pegged at $4.76. In this war, the corresponding level seems to be approximately $4.00. It is possible to view this in two ways: either as an inflationary factor in the British economy or as a deflationary factor in the American economy. Probably it will prove to be a little of both. One conclusion is reasonably certain, namely, that the depreciated pound is not an inflationary influence on American cotton, wheat, copper and other basic raw materials. Recollection of 1932 is sufficient to support this proposition.

Another phase of the gold question is the relation between sterling exchange and the purchasing power parity. In the World War, purchasing power parity between sterling and the dollar averaged in the neighborhood of $4.00 and the actual rate, pegged at $4.76, was sharply above this parity. Today the corresponding parity would be about $4.40, and the actual rate at around $4.00 is well below the parity.

We are prone to be overly conscious of purely domestic factors influencing the price level, and particularly in the United States there has often been a tendency to discuss prices in a way that ignored or neglected the international connections of prices. This war is being fought under very different international conditions from those prevailing in the last war. In the last war, the pound was seventy-six cents above the parity most of the time, and now it is forty to fifty cents below the purchasing power parity. That makes a difference in the inflationary and deflationary influences that are let loose. Broadly speaking, it is a deflationary influence on prices in dollars.

Estimated annual gold production within the British Empire is $600,000,000. As long as the United States continues to pay $35 per ounce for all gold offered, the British government need not be too greatly worried by the prohibition by the American Congress of foreign loans. To ship goods, make foreign loans, and later have the loans cancelled is one way of giving something for nothing. To ship goods and to be paid in the form of accumulation of additional stocks of a yellow metal possessing no utility at an arbitrary high price is another way of giving something for nothing. Congress does not appreciate the irony of such considerations.

Gold and foreign exchange are conditioning factors for determination of domestic fiscal policy. Owing to the fact that all countries approach this war with national debts greatly in excess of those of twenty-five years ago, they are forced to finance this war more by taxes and less by loans. Every belligerent is under pressure at the outset to go the limit in following a pay-as-you-go policy. This inclination to minimize loans and to maximize taxes points to a basic fiscal policy which should prove to be less inflationary than that pursued in the World War.

During the World War, the British government met only about 25 per cent of its expenditures by taxation. The current war budget in Great Britain calls for raising about 50 per cent of expenditures by taxes. In contrast, during our Revolutionary War, the Continental Congress raised barely 9 per cent of its total income from taxes and the by-word, "not worth a Continental", is derived from the fact that the currency depreciated to about one one-thousandth of its pre-war value.

If a more conservative fiscal policy is adhered to this time, the quantity of money in circulation should increase but not on the scale of the last war. Under war conditions the quantity of money tends to be a function of the rate at which banks increase their government bond investments and their corresponding deposits. If government bonds are bought by the public out of savings, the process is not inflationary. If the bonds are bought by the banks, the process is inflationary. During the World War, deposits of the British joint-stock banks approximately doubled and the wholesale price index slightly more than doubled. In France, the price rise correlated with the increased note issue. On a strict quantity theory basis, there is a good chance that this war will provide less monetary stimulation to commodity prices than did the last war.

In the last war, the United States had a sharp increase of demand deposits late in 1915 and promptly had the beginning of a rapid increase of wholesale prices. The rise of deposits and prices was about equal until late 1916 when prices moved about 30 per cent higher than deposits. This excess of prices over deposits was in part due to foreign war orders before the United States entered the war. The goods that led the rise of prices were the goods in most active demand from European buyers. In making comparisons, it is well to remember that the wholesale price index of this country is already about 20 per cent higher than that of 1914.

Attention may next turn to considerations of supply and demand. The rate of consumption of war materials varies with the nature of military operations and with the degree of sacrifice endured by the civilian population. Obviously the nature of military operations thus far in the present conflict does not use up materials rapidly. This may change suddenly, and I offer no prediction on this score.

As to the sacrifice by the civilian population, it would appear that the British people are being more promptly organized than before to curtail their home consumption of those materials needed for war. This applies to gasoline, clothing, food, new automobiles, etc. This internal resource of civilian self-denial is being immediately exploited by the British government whereas formerly it was only gradually utilized.

The British and French have access to American markets and can make their demand effective. The extent of war orders placed here now should not be as great as the extent of those placed here in the last war, because in many lines of industry, such as steel and munitions, those countries have a more self-sufficient industrial capacity. Moreover, war orders placed on a cash and carry basis have less inflationary effect on American prices than those placed on a foreign loan basis. Between July 1914 and July 1917, the Allies borrowed in this country about $2,600,000,000. The Johnson Act and other legislation preclude repetition of such borrowing in the present conflict.

On the side of supply, this war was preceded by a stocking-up of essential materials by the British and French governments. Moreover, potential world productive capacity of copper, steel, cotton and most other major raw materials is substantially greater now than in 1914. Consequently, scarcity or shortage of such materials is relatively remote.

In Great Britain, unemployed labor is already rather fully absorbed, but in the United States the number of unemployed is so high that full absorption of labor supply must be regarded as far more remote now than in the World War. The more remote the point of exhaustion of labor supply, the more unlikely is sharp further increase of commodity prices. The fact that there is shortage of skilled labor in special trades does not conflict with this general observation.

Furthermore, labor is better organized in both Great Britain and the United States than it was in 1914 and hence better prepared to combat the dislocation between cost of living and nominal wage rates characteristic of periods of rising prices. Labor would fight the tendency under war inflation for real wages to decline, and its fight would likely be more effective than ever before. If real wages cannot be made to decline 10 per cent or more, inflationary war financing is frustrated because the essential purpose of such financing is to levy an indirect tax on labor, to take something away from labor and apply that something to war requirements, and to do so by inducing a decline of real wages. In light of N. L. R. B., C. I. O. and A. F. of L., a material decline in real wages would be most difficult to engineer.

Finally, attention should be given to government regulation and control of prices. This is a complex subject but there are several critical comments to be made.

1. First, there is abundant past experimentation upon which to draw. The last war brought an avalanche of price controls in all countries. This war already sees similar controls established. Governments have learned much about what to do and what not to do.
2. With all of this experience, the broad lesson of the past is that political price-fixing has little or no effect in preventing an advance of the general price level if the fiscal policy of financing the war is inflationary. Large-

scale borrowing from the banks or excessive note issue will bring about a price advance in spite of any amount of attempted price control by governmental agencies. In the last war, price-fixing in the United States began only after wholesale prices had risen about 89 per cent above the pre-war level. Thereafter, 537 controlled prices were forced down 10 per cent, but, by the end of the war, the 10 per cent decline had vanished and the average of controlled prices was practically the same at the end of price-fixing as at the start. Meanwhile, 793 uncontrolled prices went up about 25 per cent. Consequently, price-fixing or no price-fixing, prices at the end of the war were about double what they had been in 1914.

3. Within certain limits set by monetary and fiscal policy, political controls can be of considerable influence. At the start of this war, governments are predisposed favorably toward full implementation of such controls. The democracies are inclined to go almost as far as the totalitarian states in regimenting their industrial life to the rigid price discipline of war necessity.
4. The United States, although still neutral, has a head start toward such regimentation. The Temporary National Economic Committee has been utilized to spread the gospel of government intervention to prevent price advances by private industry. The anti-monopoly campaign of the Administration has acquainted the public with the idea of monopolistic competition, price leadership, etc. Presumably the temporarily constituted War Resources Board prepared a report, as yet unpublished, having to do with war-time price controls. It is assumed that the War Department has formulated plans for drastic regulation of essential industries in the event of American participation in the war. Thus there is already a strong momentum in this country in the direction of a highly regimented price structure and no doubt there would be more immediate and more intensive use of such power in a new war than there was in the last war.

5. Such price regimentation has serious drawbacks. Political appointees in price-fixing jobs tend to be egotistical and arbitrary. They create a large amount of unnecessary red tape and make aggravating delays in reaching important decisions. Often the bureaucrat does not have enough technical experience in the industry under his jurisdiction to understand what needs to be done. The bureaucracy of price control tends to overrate its importance, to dodge responsibility, to suspect honest business advice of selfish motivation. It is not an altogether happy picture, but we have to face it anyway and might as well make the best of it. If we enter the war, we are morally certain to be brought within a scheme of price regimentation not greatly different in degree from that of totalitarianism. This one difference would be outstanding if we were to enter the war. Price regimentation in a new war would be under the control of bureaucrats who, for the most part, were professional bureaucrats. Price regimentation in the last war was under the control of bureaucrats who were temporarily loaning their services from business to the government. They would be at a minimum in the next war, and the professional type of person who has grown up with the government would be the chief authority in the government with whom business men would have to deal in price-fixing matters.
6. An unsavory feature of such a régime is the temptation to mix politics with business judgment. At the outbreak of the war in September, there was a flurry in sugar prices. Housewives stocked up with sugar, and grocery stores found their shelves empty. Political spokesmen quickly posed as the people's friend, promising to protect the consumer from the wicked profiteer. It was a tempest in a teapot, but political agencies wanted to take credit for stopping a price movement which was only a temporary flurry anyway. Under war price-fixing, there will be all too frequent cases of this solemn subterfuge.

Having reviewed these various factors, one arrives at the conclusion that this war carries decidedly less inflationary implications than the last one. Although I state this conclusion positively and with conviction, nevertheless I am fully aware of the difficulties of dealing with so uncertain a phenomenon as war. Much depends upon how long the war lasts, and if this war should last three years or five years I fail to see how anyone can predict the price fluctuations of that distant period. Much depends upon the nature of hostilities—whether the stalemate of the Western Front continues or violent destruction and a desperate offensive occur. Much depends upon whether the United States is drawn into the war and, if so, when. In high political quarters the opinion seems to be held that we shall not be in until after the elections of November 1940. This sounds plausible but not absolutely conclusive, and I offer no opinion one way or the other on this election timing theory. My contribution merely goes so far as to offer the opinion that this cannot be a long war without the United States being drawn in.

It may appear to many that, war uncertainties being so great, any attempt to state conclusions about the price outlook is futile. In anticipation of this criticism I make two observations. First, I believe my major conclusion to be warranted regardless of the uncertainties of the case. I refer to the conclusion that this war will be less inflationary than the last one. Secondly, I have endeavored to offer tools of analysis with which to interpret future surprise events as they unfold. There have been outlined nine principles of price analysis by which to trace the interconnections between war and prices. Application of these principles to the contemporary world crisis has been undertaken. The application will change in certain details depending upon future developments, but the principles will not change. The nine principles represent an apparatus of thought derived from the history of war and prices and from the literature of economic study. I have not invented the principles but have sought to codify them for practical use and convenience. They represent the rules, the classical laws of price behavior under war conditions, and they should afford a guide to day-to-day interpretation of war consequences no matter how long the war lasts, what form it takes, or what nations are in it.

The debt burden of the United States is an unfortunate financial condition in face of the responsibilities of national defense, to say nothing of those of possible eventual participation in this war. At the next regular session of Congress in 1940, the bad financial condition will be fully discussed. A step-up in domestic armament and national defense will be proposed. It will be expensive, and critics of the Administration will point to the $41,000,000,000 debt built up during recent years of pump-priming, experimentation, subsidization and manipulation. The Treasury will ask to have the legal debt limit raised above $45,000,000,000. The critics will say, in substance: "This brings the whole crisis in unsound fiscal policy to a head. Here we are, faced with a national defense emergency, in need of great financial strength, and what do we have? A debt load of serious proportions created in peace time, arising from the lending and spending recklessness of the last few years." As a former Treasury official has recently stated, the United States is in a precariously weak financial condition to enter a war. But so are all countries precariously weak and for this very reason there is some basis for hope of a trend toward greater sanity in fiscal policy.

About twenty-two years ago, in a program of this Academy, Dr. Hollander attacked war-time fiscal policy as inflationary. Reply was made by a Treasury official, denying inflationary implications in the huge war loans and attributing rising prices to scarcity. Dr. Kemmerer prepared a study in book form on war and prices, branding the war fiscal policy of this country as definitely inflationary, but his attack made scarcely a dent on the mind of officialdom in 1918. Similar dispute was taking place in Great Britain. The economist, Edwin Cannan, was severely critical of British fiscal policy but he was a voice crying in the wilderness and he was sharply rebuked by Treasury officials. His experience led him to conclude: "It is almost incredible now, but it is a fact that everywhere most of those who were regarded by the public as monetary experts refused to believe that the paper issues of their own particular country had anything to do with the rise of prices in that country."

During the last war, the plane of intellectual discussion of the causes of rising prices was unfortunate. In general, it neglected or repudiated monetary theories and exalted pure supply and demand theories. This former fallacy is now well known and instead of neglect of the monetary influences on rising prices, we seem to have a tendency to go to the opposite extremes. The ideological background of the inflation question differs sharply from that of the last war.

Remarks by the Chairman

Dr. Burgess: Thank you, Dr. Edie!

We now come to the period of discussion. You will remember that one of the tenets of the Academy is that it shall furnish opportunities for discussion from the floor. Those discussions are to be limited to five minutes each,[1] except for the opening discussion for which I am happy to introduce Mr. Mark M. Jones, well known as an adviser to business men. Mr. Jones!

[1] Space limitations make it impossible to print in these Proceedings the interesting discussion by several members who spoke from the floor under the five-minute rule.—Ed.

THE RECOVERY PROBLEM UNDER WAR INFLUENCES: DISCUSSION

MARK M. JONES
Consulting Economist

UNDERSTANDING that all the world's a stage, and we are but actors on it, I asked the Chairman if, in the rôle I was called upon to take, I was to agree or disagree with the speakers whose papers I am to discuss. His answer was a very wise one as usual. He said, " A little of both."

So I start in to consider the nature of the recovery problem with that in view. I should also like to go beyond his limits a little bit, and say that in any estimate of the recovery problem the psychological aspect needs to have special consideration, as well as the logical aspects so well developed in the excellent papers we have just heard. It seems to me that the effective opinion of the times does not understand the nature of the problem and does not understand the nature of an enterprise system such as we have here in the United States. It insists upon the taking of measures repeatedly which automatically debar the prospect of true or sound recovery. I do not attribute that solely to what has happened in the last seven years, nor to any one group. It seems to me that it is a development of at least fifty years, and it is predicated on attempting to do something that is utterly impossible, and that is as a people to cling to policies, part of which point one way and part the opposite way, and to keep on doing so for a long time.

The United States is at a stalemate because we are trying to do that. We have a whole system of political controls which have been built up as a pyramid of which the spearhead now is 62 federal agencies, having executive and judicial powers, of which 51 have been established in the last seven years. The effect of all this is to head us in a direction that assumes a static character of life and is predicated on a static philosophy.

It implies that it is possible to nail things down and make them absolutely dependable and secure. Against that we have a set of forces running in the opposite direction, based on science and technology and private enterprise which are, and must always be, essentially dynamic. We are trying to control dynamic forces with static policies, measures and ideas, and it will not work. It has not worked and there is no chance of really getting anywhere as long as we insist on chasing rainbows in that manner.

There is a short circuit that is also introduced in the situation by war. I imagine that the war will probably put off grappling with the recovery problem in the United States on the basis of peace-time pursuits. The war situation probably will provide an escape from the realities of a recent and unholy past, and, of course, no one can tell when or whether we shall finally come to grips with the facts.

It seems to me that the stalemate in which we have reposed for so long resulted mainly from what I would call an unsound overlordship of government in relation to business. Next, it seems to me that it comes to focus in uneconomic policies imposed in the name of labor. Then, it seems to me it comes to focus in a third way in the form of confiscation misbranded as taxation.

I may have a narrow definition of taxation, but I do not see how we can have a scale of living based on technology if we persist in indiscriminate taxation. A scale of living based on technology must respect arithmetic. That is the basis of technology. As a result of a wholly emotional approach, we are insisting on attempts to repeal arithmetic by government or law or some other magic. I am just as impatient as anyone over the fact that it cannot be done, but I have been trying to find ways of doing it for the last thirty-five years and I am beginning to think that it cannot be done.

It seems to me that the ultimate problem with which we are confronted here is that of a constantly increasing governmental overhead which is superimposed on a gradually diminishing base. I think that one of the lessons to be drawn from recent experience is that the United States is too big a country to be run either from Wall Street or Washington. It seems to me that the job has to be done on Main Street.

Until we realize that, until people go about taking care of themselves to a greater extent, and until we foster and stimulate private initiative to a greater extent, the people of the United States will keep on emulating the blind man in the dark cellar looking for a black cat that isn't there.

With respect to the second paper on "Employment and Federal Finance", it seems to me to be interesting to note that there is a relation between the accumulating deficiency in man-hours since 1934 and the curve of the accumulating Treasury deficit. In other words, there seems to be a relation between the accumulating deficiency in work opportunities and the accumulating Treasury deficit. With respect to unemployment, the crux of the problem no longer pertains to people who were once employed, but to that six hundred to seven hundred thousand net addition to the labor force of the nation which arises annually from those who come of age each year. They do not confront the same opportunity that their fathers did, because the growth of our national economy has stopped. It seems to me that sooner or later we must realize that government spending can be stimulative only in a narrow critical stage in the cycle and then but momentarily. Otherwise it is likely to make dope addicts of a large proportion of the people. Government spending has the same effect on the body of the people as dope on the body of a person.

Of course, it can be taken repeatedly, but the effect ultimately is like dope. If continued the patient probably will blow up and go crazy. With respect to federal finance, it seems clear that if we do want more revenue for the federal government, there is one method to which we can resort with a reasonable prospect of getting it. Of course, the people usually will try every way except the right way first. In this case, the obvious remedy for more revenue for the government is a reduction in the rates of taxation. We have a scale of living based on technology that depends on the flow of private capital. The flow of private capital has been seriously interfered with. Until we work out ways by which we can induce that state of confidence which has been referred to here on the platform this morning, and thus resume the flow of capital, particularly the application of capital through investment, there is not much prospect that we will resume the upbuilding of the scale of living of the people of the United States.

The one thing that I would like to qualify in Mr. Ballantine's speech is the implication that there may be a sound basis for the enlarging functions of government. Now, there may be, but I do not believe that we can concede it too easily if we want to be particular—review what we have done, what happened and whether it was worth what it cost.

With respect to "Labor Policy and the Volume of Employment", I should like to call your attention to a few items which seem to me to be noteworthy. First, the indiscriminate pushing up of labor costs has unduly accelerated the substitution of capital for labor. Then, of course, attacks are made on the machine as causing unemployment. So the charges are made against the machine instead of the primary cause which is the uneconomic pushing up of labor costs.

Seniority under static conditions cuts down the infusion of new blood, tends to maintain more of a monopoly of older workers and to prevent keeping the age groups in a working force in balance. Restrictions on production such as sit-down and slow-down strikes, of course, have had the effect of reducing the demand for labor.

I think it is about time that we examine the question as to the extent of the divergence of interest between employee and employer. So much that is done in the name of labor really is predicated on the doctrine of the class war. That brings us down to the assumption that there is so great a divergence of interest between employees and employers, that an unresponsible third party must be introduced in order to bring about equality of opportunity. So in countless places we are trying to operate one body with two heads.

It looks to me as though the divergence of interest between the labor leaders and workers is much greater than between the workers and the employers.

As to "The Influence of War on Prices", I have very little to say. This is a machine war. That means that capital goods will be more important than ever. It seems to be an apartment house war on the Western Front. The length of the war is a matter of the greatest importance, but the effect on prices, it seems to me, depends also on the policies of the Allied nations. First and most important is their strategy for the control of the raw material resources of the world. Second

is the policy they follow in their procurement of manufactured articles from North America and the conditions under which they do so. The basis of payment will also have a great effect on our prices. Then there is the factor of ability to get North American products to Europe. But more important, it seems to me, is the question as to the attitude and policy to be followed by manufacturers in the United States in procuring materials and employing labor for war supplies, and the attitude to be followed by labor leaders in confronting the war situation. These gentlemen may wish to drop the match that will touch off an explosive inflation. Labor profiteering probably will be one of the chief factors determining the influence of the war on prices.

Now, the outstanding factor in this situation, I think, is the effective opinion of the times in the United States. I do not believe our self-styled liberals understand the situation or an enterprise system. I do not think that we can keep on pursuing the idea that there is some magic in government or law that can coerce virtue into being or do the other things implicit in our rainbow chasing or in our efforts at rain making. I believe that there is a vast opportunity in the United States to do something that has never been done before in the world. I believe that we have the greatest industrial mechanism and productive potentiality of any nation—one that is the principal envy of the rest of the world. It is the opportunity to advance the well-being of more people to a higher level than ever before in history. I regret as much as anyone that so many illusions stand in the way of going ahead and taking advantage of the opportunity that science and technology and private enterprise present.

But one thing at least is now clear, and that is that more people are more dependent on capital than ever before in history, and that we cannot run a capitalistic system without capital.

PART II

WILL WAR REMOVE THE OBSTACLES TO PRIVATE INVESTMENT AND EMPLOYMENT?

INTRODUCTION *

SHEPARD MORGAN, *Presiding*
Vice President, Chase National Bank of the City of New York
Trustee of The Academy of Political Science

WE are about to open the Second Session of the day's program, dealing with the effect of war on America's idle men and idle money. The topic we have for discussion this afternoon bears perhaps a little more directly on the war than the topic discussed this morning. Our topic this afternoon is " Will War Remove the Obstacles to Private Investment and Employment? " You see, that topic is phrased as a question, and in answering the question the Academy, of course, takes no position, because the Academy cannot attempt to prophesy. Moreover, the Academy, as well as everyone else in the United States that I know of, and most of the people of Europe whom I have recently seen, regards the war as an unmitigated calamity.

Whether the present war will remove the obstacles to private investment and employment, which have been perplexing us for the past ten years, is a question which these distinguished speakers this afternoon will not attempt to solve. I imagine, that they will attempt to give you, in the proper manner of the Academy of Political Science, the facts upon which you may possibly make up your minds as to whether the obstacles will, in fact, be removed. They will also touch upon the extent to which the war itself may join with the forces that, happily, have been in motion already to remove these obstacles. I imagine the speakers will not indulge in prophecy. I do not

* Opening remarks at the Second Session of the Annual Meeting.

need to warn them that a prophet is not without honor save in his own country. The United States is pretty big, so that the destiny of the prophet is even more unhappy in the United States than in smaller countries.

Our friends, speaking from the fullness of their knowledge, will give you the facts upon which you can make up your minds as to what the probabilities are. The first speaker is John Donald Black who is Professor of Economics at Harvard University. He was for two years Chief Economist of the Federal Farm Board. He was Professor of Agricultural Economy in the University of Minnesota, and now he has come to us from Cambridge to talk on the subject, " The Effect of the War on Agriculture ". Professor Black!

THE EFFECT OF THE WAR ON AGRICULTURE

JOHN D. BLACK
Professor of Economics, Harvard University

A VERY simple way of analyzing the position of American agriculture in a new war economy will be to assume that this war is going to turn out much like the last one, and that in a year or so our whole economic machine will be geared to the production of supplies for a large fighting army in Europe, if not our own army, then that of England and France and their Old World allies. On such an assumption we can turn to the Napoleonic wars, to our own Civil War even, and to the last World War, and see what happened to agriculture during hostilities and afterward, and then apply the logic of simple analogy dangerous though it may be. Such seems to be the basis of the usual statements that one now hears. Mr. Louis Bean dealt with the subject on this basis in a discussion before Governor Harold Stasson's conference at St. Paul late in September.

For three reasons, this treatment of the subject will not serve in the present situation. First, it is not safe to assume that we shall this time also presently find ourselves engaged in the actual fighting; and to forecast how our agricultural economy will be affected if we play only the part of producer of supplies is difficult. Our experience after we declared war in 1917 will not suffice, in the present state of our thinking, as an analogy—for the later years of the present episode the parallel wanted is more nearly with what would have happened after 1917 if we had not declared war. In the second place, even if we finally enter the war, we do not know what kind of a war it is going to be. It certainly is not starting out along conventional lines.

In the third place, our agriculture is now much more under public management than on the other occasion mentioned—so much so in fact that forecasting the effect of a war of today on American agriculture is in considerable measure forecast-

ing its effect on the public programs for agriculture and upon how these will work out under war influences.

So far as the immediate situation is concerned, we need of course to be thinking of the year 1914 as a parallel rather than the year 1917. But even this is not a good parallel. So many circumstances are not the same now as then. The war itself seems to be vastly different. The demands for our export farm products may very well be different from those of 1914-16. As the prospect now shapes itself, we can see nothing more immediately ahead than a somewhat increased buying of lard and pork products, and continuance of the already higher wool prices because of increased demand upon largely foreign sources of supply to which our merchants also resort. Cotton exports are more likely to be lower than higher in consequence of the war. This does not mean, however, that foreign buying will not be in excess of the low figure of last year. Foreign reserves of American stocks have probably been nearly exhausted, and this is no time to experiment with other staples. Exports of fruit have already been hard hit. If a year hence the wheat crop is short in both the United States and Canada, the situation will be reversed, but it must be remembered that world supplies of wheat are very much larger now than in 1914. With average yields, at least two more years will be needed to reduce them to normal. Cotton supplies are even larger than wheat supplies. Another year of war will see more interest in pork supplies, and probably a little interest in dairy and possibly beef products. A third year of war, granted normal yields, will be needed to cause any sizable exports of any of this list of products except those of pork.[1]

The indirect effects of the war on our agriculture can easily be more important than the direct effects. It may take two forms, effects upon domestic demand and prices for products, and effects on the demand for labor. Should the demand for products of our industries for export stimulate after a year or two a sustained higher level of factory production and accompanying construction, and the higher prices normally as-

[1] These statements assume in part that Danish supplies will still be able to reach British markets. If they do not, American dairy and pork products will be in greater demand than this statement suggests.

and of working conditions now insisted upon by farm people. Today on almost a million farms, an automobile, a tractor, and a high school education for the boy and girl are rated as more important than paying off the mortgage. Within limits, a rise in land prices would therefore furnish needed relief to agriculture in many areas. It would help public credit agencies as well as private ones—also tax collections. Furthermore, one has reason for believing that a land boom can be more effectively stifled now than in 1917-18. For example, the public credit agencies can stiffen their requirements. Finally, should a period of decline set in subsequently, a much smaller proportion of the mortgages would be on a short-term basis requiring immediate payment.

The other important factor is the labor supply and accompanying wage rate. As has been stated in other papers, except for skilled labor bottle necks and the like, the unemployment reserves in our cities should be able to meet the industrial demands of several years of war without any rise in wages. Back on the farms are perhaps a million more who would be drawn to the cities if jobs appeared. The real danger in the situation is that prices would rise a good deal and wages along with them, and then afterward wages would not decline with prices, precipitating a new decade of maladjustments like that of the twenties. It was not so much that wages were really too high in the twenties; rather that they were too low before the World War. It was the extremely sharp break upward from the very low levels of 1900-1916 to the relatively high post-war levels that introduced severe disequilibriums within industry, and particularly as between industry and agriculture, and trade and agriculture, which were by no means leveled out by 1929, and were recreated in fact in the depression of the thirties. A very moderate increase in prices, such as we can expect in the early years of a European war, ought to be absorbed without breaking up our present wage structure. If so, there should be no deleterious effects on agriculture. A considerable increase in prices, on the other hand, would impose serious further disequilibriums on those still remaining with us from the World War. For the sake of agriculture as well as industry, the situation calls for keeping prices as nearly at present levels

as we can optimistically hope for, and for the full employment of all the price control weapons in the public arsenal, and all the collaboration of private financial and industrial agencies that can be mustered.

If somehow any increased demand for farm and industrial products that may arise in the pending war situation could be met simply by increased volume at present prices, and increased employment at present wages, all interested would stand to benefit from these increases at the time, and the aftereffects would not be highly serious, consisting mainly of readjustments to lower volume again. Should our price and wage structure break badly, the gains of the moment, for the rank and file at least, may be all swept away in the subsequent upheaval.

An increased volume of agricultural production, with no price increases, or very moderate ones, would also contribute to the better working of all the public programs for agriculture. But large price rises would disturb them greatly. It might seem at first glance that such price increases would greatly benefit the Farm Security Administration by reducing the number of cases demanding rehabilitation loans. It surely would have this immediate effect. It would also cause many thousands of such families to move to new jobs in the cities. But we have no reason for believing that hundreds of thousands of such families would not be in need of rehabilitation in the land after the war flurry was over. Come recession and large numbers of those who moved to town would return to the land as they did in 1930-33. The permanent new jobs in the city would mostly be retained by the young people now waiting on farms for a chance in the city. Mechanization of agriculture would probably take away the old jobs of the young men on the farm in the war years while they were gone.

No ordinary war could improve much the prospects for good prices for cotton in the next year or two; but if such prices should come presently, the displacement of labor by machines, and of croppers by laborers, would proceed apace. In the period afterward, the cotton cropper problem would become very acute.

As for the soil conservation program, it is possible that the increased income of more prosperous war years would be drawn off to finance needed erosion control improvements and the like; but it is also possible that the hope of cashing in on better markets and prices would divert attention away from soil conservation. A growing interest in better leasing systems and better tenure arrangements might suffer a similar partial eclipse.

As for the A. A. A. program, a real war economy situation after a few years would surely bring agriculture somewhat nearer to a " parity " of income than it has been at any time since 1925-29. Volume of production as well as price would contribute to this. How much price would contribute to it depends upon how much more selling prices advance than cost prices. This might be very little. A nearer approach to " parity " prices would be politically helpful to the A. A. A. program for the time being. In the longer run, the sooner that our farm people, and their leaders and political representatives generally, learn that any general achievement of "parity " prices is hopeless, the better for them as well as for the rest of us. Which party will have to pay the penalty for this deception of our agricultural public, and how soon, remains for time to tell. It has as good a chance of wrecking the Republican as the Democratic farm program, but under such guises as cost-of-production, or the Woodruff Bill for using parity as a basis for tariff duties. It is high time that more of our agricultural policy leaders have the courage to advance and defend parity income as a substitute for parity price.

Remarks by the Chairman

Chairman Morgan: The next speaker is the Senior Partner of one of the leading accountancy firms not only in the United States but in the world. It seems to me, from my knowledge of him, through a good many years, that he has done more than anyone to raise accountancy from a business to a profession. As you will see, he is a man of fluent mind and fluent speech. I take pleasure in introducing Mr. George Oliver May.

THE ECONOMIC EFFECTS OF TAX POLICY IN WAR AND PEACE

GEORGE O. MAY

Senior Partner of Price, Waterhouse & Co.

I FEEL grateful to you, Mr. Chairman, for the extravagant way in which you introduced me and I am pleased to have the honor of appearing before this Academy. The subject assigned for my address today must look to most of you, as it does to me, like the topic for a five-year research program rather than a twenty-minute talk. That distressed me until I heard what Mr. Morgan had to say in starting the proceedings. I also noticed that I am only opening the subject for Professor Warren, who is going to deal with the real problems upon which I shall only touch.

The question which I have been asked to discuss is the economic effect of taxation. It is interesting to note the increasing extent to which taxes are being considered in terms of their economic effects. Whether a tax is justified on the principle of ability to pay or equality of sacrifice, or upon the benefit theory, seems to be regarded more and more as unimportant in comparison with the question of the probable economic effect of the taxation. No doubt if a tax is regarded by taxpayers as unjust, that sense of injustice is apt to influence their action and thus produce one of the economic effects which must be taken into consideration.

There is no objective way of determining what constitutes relative equality of sacrifice. As Lord Stamp once put it, ". . . it is very difficult for a man to say quantitatively that one boot pinches *three* times as much as the other, even where both are his own, and how much more difficult is it for one man to say that his boot pinches twice as much as another's!"

Once the principle of progressive taxation of income and wealth is accepted (whether it be on the " ability to pay ", the " equality of sacrifice ", the " benefit ", or any other theory), the rate of progression that is appropriate becomes a matter of subjective judgment and, in practice, the effect on the economy has in periods of high taxation become the limiting factor. This fact was clearly recognized in England by the famous report of the Colwyn Committee in 1927, but does not seem to have been as fully apprehended in our country, at least until a later date.

I assume that it would be the wish of the Committee that I should direct my attention particularly to the problem as it affects our country and in the expectation that we shall not ourselves become participants in the war. I shall first devote a few minutes' attention to the problem, as it is presented to the belligerent nations, taking Great Britain as the nation approximating more nearly to our own conditions than any other.

In the first place, the difference between the problems of today and those of 1914 is apparent. In 1914 Great Britain was on the gold standard, was wedded to the idea of voluntary military service, was operating under an industrial system in which government control played an insignificant part, had a budget of about 200 million pounds, and was levying an income tax and maximum surtax each of approximately 6 per cent. At the beginning of this war (if we include in that period the year's peace that was no peace), Great Britain had a managed currency, was ready for conscription, was operating a large part of its industry under varying degrees of governmental control, had a budget of about £1,000 million, and was levying an income tax of 27½ per cent with a maximum surtax of over 40 per cent.

An examination of British expenditures for the six years beginning with the fiscal year 1914-15 leads to the conclusion that of a total war expenditure of approximately 10,000 million pounds, roughly 30 per cent was derived from current revenue and 70 per cent from borrowing. The new war budget in England proceeds on lines similar to those adopted in the World War. The estimates for a full year contemplate additional taxes of 226 million pounds exclusive of a tax of 60 per cent on excess profits. The income tax is raised to 37½ per cent, the maximum surtax to 47½ per cent and the maximum estate duty to 60 per cent. Increases in consumption taxes are expected to yield 66½ million. The estimate of the amount to be borrowed this year is nearly 1,000 million pounds; and if the amount to be borrowed in a full year

of war is estimated at only the same figure, it is apparent that the new taxes, apart from the excess profits tax, will yield only about 18 per cent of the anticipated additional expenditures.

The yield of the excess profits tax is not estimated. In the last war it yielded rather more than the income tax (including surtax). The London *Times* looks to it to become "the superlative buttress to the revenue." Since the tax is to be levied only on profits in excess of the pre-war standard, this implies that industrial profits will be greatly expanded rather than that prices and profits will be restricted (though the Chancellor did talk of avoiding inflation). If so, despite the tax of 60 per cent on the excess over pre-war standards, the position of owners of industrial enterprises will be relatively favorable in comparison with that of recipients of earned income, including officers of the armed forces, civil servants, and the great salaried and professional classes whose importance to the nation is manifest. True, the English relief to earned income is somewhat greater than our derisory allowances. But consideration of this case emphasizes the invalidity of the assumption which underlies much of our economic writing, that above a certain modest level, receipt of similar incomes implies substantially similar abilities to pay, even though the sources of the incomes are permanent and well assured in one case and fleeting and precarious in another. When taxation becomes high, acceptance of this false premise results in major injustices.

The measurement of industrial profits for short periods in times of changing prices and abnormal expenditures is one of great difficulty, and with taxation at high rates the effect of overestimation in individual cases may be ruinous. The history of British taxation suggests that efforts will be made through special allowances and tentative assessments to safeguard the industrial structure from undue hardships and to allay apprehensions which might discourage needed activities and adversely affect production. The excess profits tax law contains provisions designed to result in the tax being levied ultimately on increases in profits over the war period as a whole rather than on the basis of single years considered separately.

On the old question of the parts to be played by loans and taxes in the financing of war, I do not propose to express an opinion. I leave that to Dr. Warren. Immediately on publication of the budget, J. M. Keynes drew attention to what he called "the utter futility of the old imposts to solve the problem, even when pushed almost to the limits of endurance." He urged that the vital necessity was to take steps to restrict the rate of interest on current savings (lent to government) to 2½ per cent. Such a procedure, together with an average increase in wholesale prices of 20 per cent or more, which he regarded as warranted and desirable, and the application of the excess profits tax to the resulting increase in profits, would, he suggested, go a long way toward solving the problems of the Treasury.

The importance of the borrowing rate is manifest and is evidently fully recognized by the British government. As you know, the Bank rate, which was raised to 4 per cent on the outbreak of the war, has again been reduced to the 2 per cent previously in effect. No doubt steps are being taken to restrict the uses of borrowings to desirable objects by means other than a high Bank rate. The implied assumption of Keynes that even if old methods of taxation and finance have in other respects to be abandoned, long-term borrowing will continue, and that the rates contracted to be paid over those long terms will continue to have the same significance as in the past, seems open to question. To assume that England may borrow £1,000 million annually for the duration of the war, and that a comparison between the present value of long-term obligations if they are issued at 4 per cent or, say, 2½ per cent is the practical measure of the difference in the burden which the country will have to bear, is surely to underrate the probable effect of a protracted war on the whole fiscal system. It is difficult to see how purely voluntary subscriptions could be secured on such a basis as 2½ per cent, subject to tax.

If the war continues, it seems evident that Great Britain will not be able to finance it by methods of the same general character as those employed in 1914-18, but will be forced to resort to virtual compulsion to a far greater extent than at that time. Probable economic effects are that government control

will be greatly extended and the Civil Service will be further enlarged. Perhaps the increased mechanization of warfare will leave man power readily available, but it is to be anticipated that the demobilization of controls and civil services will prove an even more difficult problem than the demobilization of military forces.

Turning to our own position and comparing it to that of 1914, when we were still neutral, our federal expenditures are today running at the rate of 9 billions as compared with less than one billion at that time; and the maximum combined income and surtax is 79 per cent, compared with 7 per cent. Our federal death duties now run as high as 70 per cent (higher than the new British maximum), whereas then we had none.

In seeking a background for the consideration of our own problem, we may perhaps turn to the economic effects of the "war" against unemployment, which we have been conducting for several years. In this connection, some figures are in the course of publication by the National Bureau of Economic Research in the form of an interesting and valuable study undertaken by economists connected with the Securities and Exchange Commission. From this study (the figures in which must, of course, be recognized as only approximations and subject to possibly wide margins of error) some important changes may be summarized as follows:

In the five years 1933-37, it is estimated that there was an increase in cash and bank deposits of persons and institutions, other than governmental bodies and corporations, of about 8 billion dollars. There was, also, an increase in the resources of insurance and pension funds and building associations of another 8 billions. On the other hand, private holdings of securities and investments in homes decreased by about 5 billions, and the losses and dividends of corporations exceeded their earnings by about 9 billions. The authors conclude that there was a net increase of net private and business saving of something under 2 billion dollars. During the same period, government expenditures exceeded government revenues by 17½ billions of which debt repayment, loans and investments accounted for perhaps 4 billions.

Adopting an idea that has received considerable publicity in the recent past, the authors of the study have undertaken to compute the amount of what they think may be called "capital" expenditure of the government, and, by deducting from this amount a provision for depreciation, to arrive at a net figure which they treat as a part of the increase in national wealth. Deducting this figure, as well as the debt repayments, loans and investments of 4 billions, from the 17½ billions, they reduced the figure of governmental dissavings to the relatively modest figure of 4 billions.

The analogy assumed between governmental and private operations is, I think, a false one, except to the extent that governmental operations are of an essentially industrial and profit-earning character. The estimate of capital outlay made in the study includes all public works and 40 per cent of such expenditures as those of the W. P. A., the C. W. A. and the C. C. C. It seems to me excessive, and the provision for depreciation, as the authors recognize, is, owing to lack of necessary information, inadequate, so that I am not prepared to regard the final figure reached by the authors of the study of, roughly, 9½ billion dollars, as measuring with anything like accuracy the increase in the wealth of the country that has resulted from government expenditures during the five-year period.

However, some of the figures presented possess very real interest. The decline in private holdings of securities and the growth in institutional assets and in uninvested balances reflect in large measure an unwillingness to take risks, which has been one of the factors affecting adversely both industry and the revenue.

There are other aspects of our present situation which are more favorable. As I said when I last spoke to this Academy in 1937, "The effects of taxation can hardly be discussed satisfactorily without reference to the method of taxation employed." At that time, I particularly emphasized the detrimental effects on our economy of high income and undistributed profits taxes levied on the income of individual years without regard to losses in other years, and the unsatisfactory and one-sided treatment of capital gains and losses. I welcome the substantial steps that have since been taken toward remedying these unjust and discouraging provisions of our

tax law. As a result of the practical repeal of the undistributed profits tax and the enactment of more liberal provisions permitting the carrying forward of losses as offsets against subsequent gains, we have created a more favorable atmosphere for the development of new enterprises. In this improved situation, the stimulus of even moderate war purchases should, if restraint and good judgment are exercised by both industry and government, have a substantial and beneficial effect on business, profits and government revenues.

If the fact is recognized that a need does not produce a demand unless it is combined with purchasing power, and the limitations on the purchasing power of the Allies are fully appreciated, we are unlikely to have any considerable creation of new and uneconomic production facilities to meet war needs such as took place in the last war. Not only would an industrial boom based on war purchases from abroad be unhealthy in its aggregate effects, but the potential demands of the Allies would seem quite inadequate to form the basis for such an expansion. At most, they can accelerate the recovery in business which was beginning to be manifest before the hostilities became imminent, and tend to make the upward trend more enduring.

If we look back to the records of the last war, we find that in the first half of 1918, for which reliable figures are available in reports of the Secretary of the Treasury, the Allies together were spending in the United States (apart from special items such as interest and maturities) at the rate of, roughly, four billions a year. Speaking very broadly, this total was made up of about one quarter each, for purchases of (a) cotton; (b) cereals; (c) other foods; and only one quarter, or a billion dollars a year, was for (d) all kinds of implements of war. It must be remembered that prices of agricultural and other products were then two or three times as high as today. And it must be remembered, also, that the distribution of Allied purchases was largely influenced by considerations of transport and finance. Transport from the United States was easier than from other countries, excepting the Scandinavian and Iberian; and since the United States was prepared to make advances to cover all purchases in this country, the financial problem did not arise in respect of purchases here.

The position in regard to transport in the present war is not yet fully determined. However, it is apparent that the financial resources of Great Britain and France in the United States are relatively small compared to those during the last war and the position of Britain in some other countries, such as the Argentine, is probably more favorable. The productive capacity of Canada, also, has greatly increased. It is therefore to be expected that the purchases of England and France in the United States will be relatively restricted and highly selective, and that the increased purchases of one class of products will be achieved largely through the reduction of purchases of other commodities.

Assuming that we are successful in avoiding being drawn into hostilities, the war will inevitably lead to increased government expenditures, particularly for military and naval purposes, and our budget problem is likely to remain a difficult one.

Experience here and in England has proved that our present maximum surtaxes have passed the point of highest productivity in times of peace; and while the direct taxation of income in the middle income groups might well be higher than it is, it may be doubted whether an increase in these rates could as a matter of justice or politics be effected without some compensating reduction of indirect taxation. Our efforts should, therefore, be directed to eliminating waste and increasing the national income, and the one thing that seems to me to be clear from our experience of recent years is that spending by government does not provide a satisfactory way of achieving these objects. Private industry must be revived, and, as I have suggested, the conditions are in important respects more favorable to revival than they have been for some time.

Remarks by the Chairman

Chairman Morgan: Thank you, Mr. May!

Our next speaker was formerly connected with the Federal Reserve System and subsequently went into private business. He was then transplanted to that heaven of thinkers at Princeton, the Institute for Advanced Study. I welcome a familiar figure at our Academy sessions, Mr. Robert Warren!

WAR FINANCING AND ITS ECONOMIC EFFECTS

ROBERT WARREN
Professor, School of Economics and Politics,
The Institute for Advanced Study, Princeton, N. J.

To borrow a phrase which St. John Chrysostom used in a very different association, war seems to many Americans "a desirable calamity". The adjective, we may suppose, is applicable to wars in which this country does not participate; but in early September, it appears, a good many people seemed to hold the view that war in Europe spelled prosperity in the United States. The coincident spurt in business activity and in commodity prices gave color to the argument, but that modern Delphic oracle—the stock market—expressed itself after the traditional manner of oracles. It declined in August in anticipation of war, and on the realization of its apprehensions rallied by approximately the amount of the previous decline. It then lapsed into mystic and noncommittal silence.

We have no intent of passing a moral judgment on this attitude. In recent years our economy has been relatively depressed compared with that of all the major European countries. The margin between our inactivity and their activity more or less measures the difference in the part played by war preparation in the respective economies. If certain persons believed that a European war would increase the element of war-demand in our economy, and so provide for a fuller utilization of our personal and material resources, they were basing that belief on a substantial precedent. For at least the past three years, and in instances over a longer period, the economy of every large nation in the world, with the single exception of the United States, has been so heavily conditioned by war preparation that armament has become the foundation of its industrial activity, and especially of its employment. The "threat of peace", however cruel and cynical the term may sound, was no empty phrase in Europe at any time in

1939, whether before or after September 1. The economy of Europe had become so characteristically a war economy even before that date that, although war might be a disaster, any peace which would have abruptly reduced the existing magnitude of armament demand might have been economic catastrophe. This elemental fact must be borne in mind, both in analyzing the problems of war finance, and in undertaking our estimates of its economic effects. In a military sense, we say that the war is but ten weeks old; but economically speaking the war is now in its fourth year. Since the middle of 1936, the economy of Europe has been a war economy; its finances have been war finances. In considering the economic effects of war and war finance, the fact of duration has already entered the account.

Before discussing the effects of war finance, we propose to explore war finance in theory as well as practice. Considering the importance of the topic, it might be supposed that the theory of war finance would have engaged the attention of economists—that they would have subjected it to the same objective, severe and critical scrutiny as military theorists devote to the study of war itself. Actually, the literature of war finance, while voluminous, is on the whole descriptive, uncritical and non-theoretical. Because some sort of theory seems prerequisite, we shall attempt to improvise one.

War Costs. War finance starts with an analysis of war costs. The costs of war fall under three heads:

1. The direct fiscal cost of prosecuting hostilities;
2. The indirect, non-fiscal burdens on the community incidental to the conduct of war;
3. Such economic costs of post-war readjustment as may be directly attributable to the antecedent war.

It is quite possible that the last two exceed the first in any major war, but to a great extent they derive from the first; that is, they are functions or consequences of the method of meeting the actual cost of the direct war effort. War finance comprises the methods employed to meet the war costs. Its area is adjacent to, but quite distinct from, the narrower and simpler field of industrial mobilization.

Theory of War Finance. The immediate objective of war finance is to increase the goods available for military consumption. Under severe war conditions, it is not possible greatly or promptly to increase the aggregate of national production. Indeed aggregate production may fall. Essentially the aim of war finance is to widen the margin between civil consumption and a limited national production, and to canalize this margin into military consumption. From this approach, it is at once apparent that it is impossible to shift the direct costs of war to posterity. The direct costs of war are paid in cash at the time, exactly as the costs of producing a motor car are paid in cash at the time.

In short, war finance aims to capture the margin between the total national product and the share of that product allowed to the producer for his own consumption. This margin can be considered as analogous to savings, or it may be assimilated to Marx's concept of surplus value. The great difference is that war finance exceeds the limitations placed on divertible savings, and the state, beyond any private agency, has access to surplus value. War finance, therefore, in any considerable war, employs some form of duress to increase this margin between the national product and the share allowed to the producers thereof.

World War Finance by Inflation. In the World War the method involved duress by a combination of force and incentive. Its main reliance was inflation which reduced civil consumption by progressively shrinking real incomes, by enabling military demand to overbid civil demand in the market, and by providing a strong incentive for increasing total production by its successful appeal to the profit motive. This pattern was followed by all the belligerents, and demonstrated its capacity to support war efforts and war costs that had formerly seemed unimaginable. But it placed a load upon the monetary and credit mechanism under which the entire structure among many of the belligerents eventually collapsed. The greatest single economic effect of the World War was such irreparable collapse to so many overloaded monetary systems, that the entire international money system was destroyed. Further, the nations whose monetary systems had collapsed resorted, after abortive attempts at reconstitution, to systems of economic and monetary nationalism, in which the nature and function of money was profoundly altered. In distinction, they adopted non-monetary economies. The difficulties experienced by nations with non-monetary economies in competing with those still operating a monetary economy of varying stages of infirmity may be listed as one of the economic causes of the present war. It is pertinent to note that this effect derived neither from the World War as a war, nor from the peace treaties; it derived from the methods of war finance employed.

Contemporary War Finance. It requires some temerity to speak of the war finances of the present conflict, and to attempt to fit the fragmentary data into a schematic pattern that would justify deductions. One commonly hears two comments, plausible enough to be arresting, and inaccurate enough to justify rebuttal. The first is that finance will play no considerable part in the present conflict. This is quite invalid, unless one defines the statement as meaning that the particular pattern of monetary war finance used in the World War is not being followed. There are two reasons why that particular pattern may not be followed—none of the belligerents has a monetary system that could even for a short time support the strain carried for four years, two decades ago; and, each of the three may be imagined to have learned from its own experience, that while war finance by inflation has familiar and tested advantages, its ultimate penalties argue that it should be employed, if at all, only as a last desperate resort. Second, it is sometimes said, because of the promptness with which elaborate controls have been introduced, that war finance in the present conflict began where it left off in 1918. Nothing could be more specious. The essence of World War finance was inflation. In the present conflict the essence of war finance is to be found in a series of integrated controls that individually and as a composite would be defeated by even a comparatively small admixture of inflation. It is true that the belligerents in the World War introduced a large number of controls into a general scheme of finance by inflation; but that is a very different thing from introducing inflation into a general scheme of war finance by integrated controls. Nevertheless the familiar indicia of inflation are already perceptible in the finances of each of the belligerents.

Description of Contemporary War Finance. The measures adopted suggest that each of the belligerents has this time more

clearly than in 1914 recognized the nature of war finance, and has proceeded more directly and more schematically toward the conscious capture of the margin between national production and civil consumption. First, there appears to have been an attempt to stabilize individual money incomes, for the laborer, the entrepreneur and the rentier. Second, there is an attempt to stabilize prices by elaborate mechanisms of price-fixing. Third, there is a concentration of war purchases within the area in which these controls are accepted. Fourth, there is a coördinated effort to reduce civil consumption, both by the rationing of commodities and by a steep increase in personal taxation. Supplementing these devices, a complete control of the international movement of capital ensures that savings, if any, will be retained within the country; and an equally complete control of the domestic capital market ensures that these savings will be invested, if at all, only in war loans or other issues recognized as furthering the progress of the war.

At the same time there appears to have been, in England at least, an elaborate effort to pass on to the community a considerable burden of incidental war costs that might have been assumed by the Exchequer. It is doubtful if anything like the full cost of maintaining the evacuated children has been borne either by the state or by the parents; and every letter from England describes the volume of "war work" allocated to unpaid personnel. Just as in 1914, the belligerents seem to be following a common pattern, but it is very different from the pattern of 1914.

The Conscription of Labor. In one respect, England appears so far to have deviated from the continental plan. On the continent there has been a sort of conscription of labor. The worker's freedom of movement has been restricted. The industrial worker is obliged to pay a kind of income tax in labor, rather than, or as well as, a money contribution. This, too, follows the general theory, for presumably the additional hours of labor increase the national product, but do not correspondingly increase the worker's claim to a larger share of that product. This device does not appear to have been invoked yet in England, where there are still a large number of unemployed. In France, and especially in Germany, a labor shortage has developed, but so completely has Germany freed itself from the price system that not even an acute scarcity of labor has the effect of raising wages. By contrast, in England there has been a rather general wage-raising movement, in spite of unemployment.

Non-Monetary War Finance. While this elaborate scheme for capturing the surplus values of the community and canalizing them into the military service comes under the head of war finance in England, it follows a pattern not unlike that of the German economy over a longer period. For convenience it can be called non-monetary war finance, not because it employs no money, but because the pecuniary element is relegated to a secondary position, rather than the primary position which it occupied in the World War.

Immediate Economic Effects of Non-Monetary War Finance. In discussing the economic effects of contemporary war finance, it is convenient to consider them in two distinct phases—the effects during the war, and afterward. War finance by inflation supported an enormous military effort through four years of conflict, of which the most inactive week surpassed the sum of the effort on the present Western Front over the initial ten weeks of the present war. With all its defects, inflation provided an incentive for economic exertion—a meretricious and illusory incentive, it is true, much like the incentive with which the mechanical rabbit inspires the racing greyhounds. War finance by rigid controls provides no comparable incentive; and while patriotism is a powerful emotion, it remains to be seen whether patriotism alone is as effective an incentive as patriotism spiked, shall we say, with a wee slug of avarice. There is also the basic question whether an economy functions or can function as well under a set of official controls as within its more familiar framework. It seems to me significant that Germany, with all its controls, had developed a labor shortage even before mobilization was complete; and equally significant that England still has numerous unemployed ten weeks after hostilities began. It is possible to blue print a set of controls that would delight the heart of any economic planner, and still leave pretty serious questions as to their specific applicability to the problem in hand, namely, warfare. The Duke of Wellington once received a draft of

recruits. After inspecting them, he remarked disconsolately: "Perhaps they will frighten Napoleon; they certainly frighten me."

In considering the eventual consequences, it is important to distinguish between the economic effects of war and the economic effects of war finance. The economic effects of war depend on a number of unknown factors. The economic effects of war finance depend on factors now in being, whose nature can be analyzed and whose purport can be recognized. This was illustrated in the World War. Before the end of 1914 a great many people realized that the methods of war finance were overstraining the monetary and credit structures of the belligerents; and that only an early peace could prevent the collapse of those structures. The analysis was sound, but the inference commonly deduced—the alternative of the early peace—was false. An analysis of the analogous financial history of the American Confederacy would have provided the correct inference; and acquaintance with our Reconstruction Period would have even permitted a forecast of the Treaty of Versailles.

In the present scheme of war finance, the control of price occupies the focal position held by money in the World War. In 1914 the first and definitive act of war finance was the inclusion of the money system within the active sovereignty of the state. In the present war the first and definitive act of war finance has been the inclusion of the price system within the active sovereignty of the state. This is regarded as a temporary measure, but a few months will suffice to weave it inextricably into the fabric of the belligerent economies.

The general social implications of the extension of sovereignty have been expounded in the recent Encyclical, which I assume every member of this audience has studied. I shall confine myself to a single aspect. By including the monetary system within the area of national sovereignty, World War finance destroyed the international money system. By including price within the area of national sovereignty, the present war finance moves to destroy the international price system and the international market.

The inclusion of price within the area of active national sovereignty may sound at first like a mere academic abstraction, but its implications are more penetrating and far-reaching than one might initially recognize.

First, labor may not be a commodity, but wages are an integral part of the price system. Referring again to Marx's theory of surplus value, so heavily applied in contemporary war finance, one must recognize that the inclusion of price within the area of national sovereignty has given the state access to the capture of that surplus beyond any that society ever accorded to private capitalism. Looking back over history one must be struck by the fact that except for brief interludes a larger or smaller fraction of the labor force of the community has always been " unfree ", its " unfreedom " ranging from simple slavery through serfdom to indentured service or peonage. The inclusion of price within the area of the active sovereignty of the state seems likely to recreate some form of " unfreedom " in labor, although its exact shape is unforeseen.

Second, the destruction of the international price system and the international market implies an extension of the principle of autarchy. One of the most assured economic effects of the present programs of war finance will be the compartmenting of the world into sovereignties whose trade relational will be governed not by price, but by license, barter and quota.

Third, an autarchic world will continue to be an armed world, and, given the present concepts of sovereignty, the peace which will emerge from the present war will be no more than an armed truce. One of the economic effects of the present methods of war finance will be the continued loading of the world economy with a heavy burden of armament. The contemporary methods of war finance confirm rather than dispute the present concept of sovereignty, and this concept does not point in the direction of peace. Perhaps the most assured economic effect of the present methods of war finance is the next war.

Remarks by the Chairman

Chairman Morgan: So many times in listening to Bob Warren I have been distressed by the thought that I wished I had said first what he said. He has an uncanny faculty of putting things in just the way that makes the vague thoughts which some of us have click into place.

The next speaker is a partner in an important investment house in New York. He is an expert in railway investments and as such he is the chairman of the Railroad Securities Committee of the Investment Bankers Association of America. Mr. Edward H. Leslie!

RAILROAD ADJUSTMENT TO NEW DEMANDS

EDWARD H. LESLIE
Of Wood, Struthers & Co.
Chairman, Railroad Securities Committee of the Investment Bankers Association of America

THE main topic of this afternoon's session is, "Will War Remove the Obstacles to Private Investment and Employment?", but the particular subject on which I have been asked to speak is, "Railroad Adjustment to New Demands". This latter topic, which I shall discuss first, is, I think, a fairly simple one, and already we have a number of indications that the railroads can adjust themselves promptly to some rather extraordinary demands on their services. It is most important that they can continue to do so, for a breakdown in transportation might provide the necessary excuse for the government to take the railroads over, and Attorney General Murphy has already rendered an opinion that this can be done under existing statutes and even prior to our actual entrance into any war. I doubt if there is anyone in this audience who does not realize that federal control and operation of this $26,000,000,000 industry would, without much doubt, through its many ramifications, prove a serious blow to the American system of private enterprise. Let us review then what the railroads have done in the last two months, for, in many respects, it has been a physical accomplishment over which the railroads can be justly proud.

Some weeks before war was declared the railroads, aware that the worst might happen, decided to take inventory of their facilities and equipment in order to ascertain whether or not they were prepared to meet the emergency which has subsequently arisen. Their investigation disclosed what to the layman was a rather serious situation. They had 627,000 fewer cars and over 13,000 fewer locomotives than in 1929, the year of record traffic. More than that, it was found that the ratio of unserviceable cars was twice that of 1929 and that the per-

centage of locomotives in need of repair was a third greater. This, of course, on a casual appraisal indicated an almost alarming deficiency in total transportation capacity. However, railroad management has not been asleep, and the necessity induced by hard times has resulted in an outstanding improvement in efficiency.

Without attempting to delve into technicalities, freight trains of today can do more work and do it better and in less time than those in service at the end of the World War. For instance, freight cars average eight tons more in carrying capacity, locomotives average 43 per cent more pulling power, freight trains go 64 per cent faster on the average, and the output of transportation for each hour that the average freight train is on the road is 116 per cent greater. In other words, this simply means that the carriers can now haul much more freight with less equipment.

Almost simultaneously with the declaration of war the railroads set in motion an extensive program of repair and rebuilding of cars and locomotives and ordered considerable new equipment. The railroads' plans were based on more than the usual seasonal upward trend, but few of them expected the influx of traffic which descended upon them almost overnight. Never in their history had there been such a sudden and unprecedented demand for cars. The problem was not only one of equipment but the difficult matter of getting the thousands of empty freight cars, scattered throughout the country, to the principal loading points at the quickest possible speed.

Two important agencies, developed since the World War, functioned toward this end, coöperating with admirable smoothness. The Car Service Division of the Association of American Railroads saw that empty cars were quickly distributed, cars were loaded heavily and without waste of time, frequency of trains was increased, locomotives unused for a long time were fired up and pressed into service, movements through terminals were speeded up, and every delay possible and all preventable waste motion eliminated. The thirteen regional Shippers' Advisory Boards functioned remarkably well in seeing that cars were promptly unloaded. During this period traffic showed one of, if not the sharpest, increases in the history of the carriers. Before the present war carloadings for August averaged only 672,000 per week, but by October 21, the peak week, they had increased to 861,198 cars—a gain of 28 per cent.

Shortages of cars obviously developed in certain types of equipment and at certain key points. But the delays, considering the problem, were relatively small and were not serious; in fact, the railroad plant as a whole was far from taxed to capacity, and there was an overall surplus of equipment.

The carriers have not stopped here. Along with their improvement program several thousands of men have been added to the payrolls, actively at work on trains, in the yards, on tracks, and in shops to prepare the railroads for further increases in traffic that may come. They have on order approximately 60,000 new freight cars at an estimated cost of $150,000,000, and new locomotives, running into many millions more, have been ordered since the war started. Moreover, they have ordered almost as many new rails and fittings since the first of September as were ordered during the entire first eight months of the year.

As you know, there is always a seasonal peak in railroad traffic coincident with the movement of crops, heavy coal and ore shipments for winter stocking and the usual seasonal upturn in industry following the summer let-down. Now that the peak in traffic is successfully behind us, the roads will have a breathing spell of from six to nine months not only to complete the program already laid out but to prepare themselves for any further increased demands as they develop.

No one, of course, knows what these demands may be, but we do know that in September and October of this year the roads hauled practically as large a volume of freight as they moved in September and October of 1918, when traffic reached its peak in the last war. So many factors are different this time that it would be just a waste of time to attempt to guess what the railroads might be called upon to perform in the event we should become involved in the war or that the present stalemate on the Western Front should burst into large-scale military activity. However, in September and October of 1929 the railroads hauled just over 24 per cent more traffic than they moved in September and October of this year and they moved that boom-time traffic with no serious delays in shipments.

I think we can conclude, therefore, as a result of the program already under way, and with the time element now in their favor, that the railroads can adjust themselves from a physical viewpoint to any reasonable war-time demands.

The general subject of this afternoon's session is, "Will War Remove the Obstacles to Private Investment and Employment?" I would like to discuss this from the viewpoint of the railroads. We might forget about the employment question if we could be sure that private capital would once again flow into the railroad industry. But, down to date, I do not believe that the war has changed materially, if at all, the viewpoint of those who normally finance the railroad industry. As you probably know, the large life insurance companies own over 25 per cent of the railroad bonds, with the balance held largely by savings banks, commercial banks, and various other types of financial and educational institutions and foundations. What is their point of view at the present time and has there been any change since the war started.? Previously, practically all of these institutions have been sellers of railroad obligations. It is not so many years ago that railroad securities totaled almost a third of the admitted assets of the life insurance companies of the country; but as they lost faith in the railroads this proportion has dwindled sharply. Even ten years ago railroad securities were about 18 per cent of their total assets, but today these total less than 12 per cent. I am sure that this viewpoint has not yet changed. Savings bank investment in the railroad industry has been sharply reduced because of the fact that but few railroad obligations qualify any longer under the laws governing savings bank investment. As regards the commercial banks, the bank examiners have been actively urging the weaker institutions to liquidate their railroad holdings, and the same point of view seems to be held by most of the other large institutional holders of railroad securities. So far at least all the war has done has been to raise the prices at which they would be willing to sell their railroad securities. But they nevertheless wish to sell them.

There seem to be about seven principal reasons why these institutions which have financed the railroad industry in the past are no longer willing to put their money into it. Summarized, these are as follows:

1. Competition from trucks, automobiles, buses, airplanes, pipe lines, inland waterway barges and steamships.
2. Long-term downward trend of rates.
3. Upward movement of wages, now at an all-time peak.
4. Deferred maintenance.
5. Lack of leadership in the railroad industry.
6. Lack of shipper coöperation.
7. Lack of progress toward consolidations.

It is perhaps too much to expect in a democracy that a problem as complicated as that of the railroads could be corrected in the few short years since the railroads ceased to have a monopoly on the transportation of the country. But there is an answer to each one of these problems, if the people of this country wish to solve them; in fact, I take the optimistic view that at least a start has been made in removing some of the greatest impediments to railroad prosperity.

Competition from Trucks, etc.

Truck competition is, without doubt, something which the railroads can meet only in part, and there is nothing to be gained by belittling the problem when it is known that the registration of motor trucks, tractors, trailers and semi-trailers increased from 215,000 in 1916 to somewhere in the neighborhood of 5½ million at the present time. You must recognize, however, that the trucks were allowed to do pretty much as they liked prior to 1935, when the Motor Carrier Act was passed. This subjected that industry to regulation for the first time, but it has been a tremendous job for the regulatory authorities to get started on regulating an industry concentrated in the hands of thousands of small owners. The Motor Carrier Act was intended to affect only vehicles operated in interstate commerce, thus leaving a large part of the industry practically unregulated. As you all know, there have recently been some rather broad decisions re-defining interstate commerce. One of these has even said that the Consolidated Edison Company of New York operates in interstate commerce, or can be regulated by federal authorities, the same as if it did.

We have heard enough complaints from the various trucking organizations in the last year or so to believe that regulation is now taking effect, and that their methods of doing business will have to be changed in many important respects. This all means, of course, that the costs of truck operation are going up and that truckers must obtain higher rates for their services to make ends meet, thus reducing the differential between this form of transportation and the railroads. Moreover, the Lea Bill (which was passed at the last session of Congress) and the accompanying Wheeler-Truman Bill (now in conference) specify that the motor trucks and the railroads must be regulated in more or less equality. Certainly equality of regulation is an important step in favor of the railroads. This, of course, is not going to put the trucks off the highways, nor does any intelligent person think it should. This type of competition provides a flexibility and special type of service which the railroads have had great difficulty in meeting as they are handicapped today. On the other hand, the very essence of the problem indicates that coördination of highway with rail transportation is a logical development and, in the long run, would best serve the public interest.

Referring again to the Motor Carrier Act of 1935, this was an important step toward permitting the railroads to acquire their own truck lines and coördinate them with their rail services, and a number of important railroads are now operating fleets of trucks. Already their short experience has proved conclusively the many ways in which the use of the highways by a carrier fits into the regular operation of its rail services and gives the shipper a flexibility and dependability of service not provided by either form of transportation by itself. It is unfortunate, however, that the law, as it is being interpreted by Division V of the Interstate Commerce Commission, prevents the railroads from operating these trucks in service beyond their own lines or operating in a manner that is competitive with their own rail operations.

The Union Pacific, the Chicago, Burlington & Quincy and the Chicago & North Western railroads were recently prevented from acquiring control of the Union Transfer Company. It was their intention to use this agency as the nucleus for developing a complete and comprehensive trucking system sufficient in scope to bring about full coördination of rail and truck facilities in the general territory served by these roads. In his concurring opinion refusing to permit this acquisition, Commissioner Eastman stated as follows:

> It appears that the three railroads by no means intend to confine the use of the trucking company to coordinated service in connection with their own operations. They propose to operate it to its own best advantage as a motor carrier in service which is strictly competitive with rail operations as well as in coordinated service. In fact they could hardly do otherwise in justice to each other as stockholders. It is also to be observed that they propose this undertaking as merely the first step in a much broader enterprise of similar character to be established by acquisition of other trucking companies.
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> I am not satisfied that in the present stage of motor carrier development such an undertaking is consistent with the public interest. It is true that we have power to prevent a motor carrier so controlled from being used to the damage of independent competitors through the establishment of unduly low rates; and it is also true that any damage which might come from superior service can hardly be regarded as contrary to the public interest. Nevertheless a large motor carrier backed by the financial resources of three great railroads and by their influence with shippers presents possibilities of unfair competition which it would be difficult to guard against. The penetration of territory served by other railroads is also to be considered.
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> The time may ultimately come for a considerable degree of union between these rival branches of the transportation industry, but I am not persuaded that it has yet come. For the present, therefore, I believe that the emphasis should be on the establishment of coordinated truck-rail service rather than on the domination by railroad companies of trucking operations per se.

This appears to be a restriction which the public interest hardly demands; in fact, a trucking combination with such responsible financial interests behind it could, it seems, give the shipper an improved brand of trucking service in that territory. This action of the Commission prevents the railroads from satisfying some of the chief complaints of the shippers against the railroads. There are many types of goods which require less packing when shipped by truck; there are articles of mixed class ratings, or commodity groups; shipments to meet emergency conditions where trucks are faster; many articles of unusual shapes or sizes which require special service or are liable to special charges; many types of goods which, if sent by rail, require special packing to prevent pilferage (cigars, for instance); shipments which must be forwarded or

received at irregular hours; goods which can be shipped in sufficient quantity to claim truckload rates but not carload rates; and goods to be shipped c.o.d.

Such problems can be solved only in part by coördinating truck with rail service, and it is difficult to see why a railroad owning a fleet of trucks could be construed as operating against the public interest when it makes complete use of its facilities, even though this involves it in competition with other truck owners. Accordingly, it appears desirable that the railroads should be permitted to own and operate their trucks with fewer restrictions as to the routes over which they may operate and as to the character of their services.

Aside from hauling commodities a longer distance, which does not seem to be the essence of the situation, the railroads have a similar problem in the handling of express shipments. The Railway Express service is a logical development in truck and railroad coördination, and it seems that the public is adequately protected against certain semi-monopolistic characteristics of this organization on the one hand, and have been provided with a very reliable service on the other. What more logical development than that the railroads use the Railway Express Agency as the nucleus for owning and operating all their various trucking services?

Former Coordinator Eastman, as a result of his survey of the l.c.l. merchandise traffic of the railroads, felt quite emphatically that this traffic should be handled collectively on a nation-wide basis, and his committee suggested that this service should be pooled in the hands of two competing railroad-owned merchandise agencies, each national in scope, of comparable strength, and operated by independent management. While Mr. Eastman realized that extension of the facilities of the Railway Express Agency for this purpose might establish a dangerous precedent in nationalization, yet when the advantages and disadvantages were weighed it was his conclusion that the railroads should immediately, and even as a matter of compulsion, form one, or, if necessary for competitive reasons, two or three such agencies. Although many of the railroads agree in principle that such an organization should be created, other railroad executives prefer to develop their own trucking subsidiaries. Since it was the conclusion of the Coordinator's experts that the roads could save in the neighborhood of $100,000,000 a year by adopting his committee's plan, it would appear that the duplication of facilities that would result from building up a number of organizations would be a luxury that the railroads could hardly afford under present-day conditions.

If there is really danger of government ownership of the railroads, and many authorities have said it is inevitable, the managements should reconcile their differences and as soon as possible come to some definite conclusions on unifying their trucking operations. If this cannot be done under the present law, or under the provisions of the law expected to come out of the conference on the Lea and the Wheeler-Truman Bills, the railroads should attempt to get started in the legislative mill a bill to make this possible.

They might logically draft a law which would make the Railway Express Agency the truck subsidiary for all of the carriers. A start in this direction might be made by giving the Railway Express Agency, or its present interstate trucking subsidiary, Railway Express Motor Transport, Inc., a certificate of public convenience and necessity to operate in interstate commerce in all parts of the country. A development of this kind would be of far-reaching importance, for, not only would it give the railroads a greater degree of flexibility and many additional time schedules, but it should restore much of their lost traffic.

This convinces me that there is a long-pull solution, at least in part, to the problem of truck competition.

There is another point which I think could be brought out while we are on this subject, and that is the present taxation of highway carriers operating as a direct subsidy from the state, and this applies to inland waterway carriers. There again this problem is in the course of correction, although, of course, no one can tell whether it can or will be completely corrected. At least two states, however, recognize that the taxing system is very much too easy on the highway carriers. In the states of Kansas and Illinois (there may be others) an engineering investigation is made which establishes first the cost to the state of truck operations and then the trucks are assessed on that basis. In the case of Illinois, such a study found that the

annual highway cost was approximately $116,000,000 a year and that all classes of highway vehicles were contributing only about $52,000,000 toward it in the form of registration and license fees and motor fuel taxes. Trucks have since been assessed on a basis of costs which are very much higher than they had been paying and, of course, many of them could not operate at rates lower than the railroads were charging, which is necessary to take most types of business away from the rails.

Certain states in the South have a different kind of regulation, due to accidents on their highways between private automobiles and trucks. The latter are forced by law to keep off the highways on Saturdays, Sundays and holidays. Everyone knows of this travel hazard, and if separate trucking highways were built at the expense of the truckers we could then have a better idea of just where the economic balance lies between the two forms of transportation. Without much doubt we would come back to the quite well-founded conclusion, that the trucks are superior in short-haul and the railroads in long-distance handling of traffic. So you can see that there might be a reverse trend away from the trucks toward more intensive use of the rails.

I do not think the railroads can do very much about airplane competition, but on many competing routes they have met the challenge with the well-known streamliners. The total influence of this competition is not vital in any event at the present time, nor can it be for many years. Pipe lines have demonstrated the value of their special type of service and the carriers can do little about it.

Inland waterway barges and steamships, strangely enough, have never been regulated. Under the previously mentioned Lea Bill and the Wheeler-Truman Bill (now in conference), these agencies are regulated for the first time.

Long-Term Downward Trend of Rates

The next argument against the railroads is the long-term trend of rates, induced, admittedly, in part by competition. On the record I would, undoubtedly, have to agree that the trend has been downward for a great many years, but an increase in rates in the fall of 1937 and another in the spring of 1938 have raised the general average to a level somewhat higher than that which existed five years ago. This, of course, refers to freight rates. Since I do not think this is generally recognized, perhaps it would be worth while to quote the comparable figures taken from Moody's *Manual*. The average freight rate for the Class I Railways in 1934 was reported at 0.978 cents per ton-mile, whereas the average rate for 1938 was 0.984. The rate for 1939 is probably a shade higher, as the large increase in 1938 was not put into effect until about April of that year.

An interesting and perhaps very important experiment in a new form of rate-making, imported from England, Australia and France, is being tried out in Canada. This is known as the "agreed charge" form of rate-making. The technique of this is complicated, but, stated simply, a shipper can agree to give all his business to a railroad for, let us say, a certain percentage of his gross sales. The shipper knows what his transportation costs have been, and the railroad might quote a lower figure, which it could do if it knew that it would get all the business, and could organize its facilities to move it in the most economical way. If this form of rate-making should prove successful in Canada, where conditions are somewhat similar, it might be adopted in this country. The whole purpose of it is to enable the roads to compete with the privately owned (many of which can be regulated only in part) as well as the common carrier trucks. Highway contract-carriers make their rates on a somewhat similar basis.

Upward Movement of Wages

The railroads, perhaps, have been our most strongly organized industry as regards unionization of its employees, and the workers have frequently used their power to obtain for themselves wages in advance of commensurate increases in the cost of living. However, prior to the present Administration (which has been obviously pro-labor) railroad employees, on at least a few occasions, accepted reductions in their wages; in fact, they accepted a 10 per cent reduction in wages in the fall of 1931, which was not fully restored until some time after the present Administration came into power. With Administration encouragement to ask for increased wages, on the theory that it created additional purchasing power, it was not surprising that the railroad employees in 1937 made exorbitant

demands. All groups of employees in that year received substantial increases, and the level of railroad wages put into effect at that time is the highest in the history of the railroads, on both an hourly and annual basis, and also higher in relation to the cost of living index than ever before. If this country ever again reverts to a régime of good old-fashioned common sense, who can say that every time the railroad employees ask for higher wages they will be granted unless justified? I think most of us will agree that higher wages are a good thing if the wages of the investor in the same industry are also good and the trend is toward a lower and lower unit cost.

While on the subject of railroad wages, public attention should be called as often as possible to the inconsistencies and inequalities governing the manner of payment of a large portion of our railroad employees. I refer to the so-called "featherbedding rules". This is what the railroad employees call them, while the Interstate Commerce Commission's description is "time paid for, but not worked". This so-called "featherbedding", the term applied in railroad circles to the contracts under which engineers, conductors and certain other workers receive pay for work not done, is an old practice and, at the outset, was apparently a perfectly legitimate way of evening out inequalities that were at the time unavoidable in railroad employment. But in recent years, due to the great speeding up of railroad service, both passenger and freight, many of these working rules are entirely obsolete, and, according to the figures of the Interstate Commerce Commission, are now an additional wage burden on the railroad industry of well over $100,000,000 a year.

The basis of payment of the so-called "running crafts" is very largely a day's pay for eight hours' work, or for 100 miles' run. It originated at a time when eight hours' service and 100 miles' run were reasonably comparable. Now, however, the rule applies to the engineer or other workers on a train that today might do 400 miles in six or seven hours. For this run such work would now receive four days' wages. Any number of instances might be given to illustrate the effects of such discrimination not only on the railroads, but to large bodies of railroad employees themselves. This is only part of the story, for in addition to the rule basing pay on the antiquated speed of 12½ miles an hour, there are many restrictions having to do with the separation of different kinds of work. Just how one of these rules works was recently explained by one of the larger railroad systems, as follows:

> A machinist, removing a steam gauge for test would be required to have a sheet metal worker disconnect the steam gauge pipe. In the removal of an electric generator from a locomotive three different mechanics could claim a portion of the work—an electrician to disconnect wiring, a sheet metal worker to disconnect steam and exhaust pipes and a machinist to remove the generator. The entire job could be done by one man in 30 or 40 minutes; in fact, in some instances more time is lost waiting for mechanics to get on the job to do their portion of the work than would be required to perform the actual work.

A rule which costs the roads millions is that which prevents road crews from doing any kind of switching services at terminals. This one item is reported to cost the Chicago & North Western Railroad in the neighborhood of $300,000 a year. The Lehigh Valley, under a decision of the Railroad Adjustment Board, gave a small number of workers on the Lehigh Valley Railroad a payment estimated at $241,000 in April 1937, for which very little work was performed. An award amounting to about $600,000 was made against the "Rock Island" in a somewhat analogous case.

Numerous incidents of a similar nature could be recited; and the layman immediately wonders why the railroads submit to this form of sabotage. The explanation appears to be that decisions of the Railroad Labor Board are, theoretically, final, the carriers having no right of appeal to the courts; and, since hearings before the Board rarely come to the attention of the public, the railroads never have had the opportunity of placing their cases before the high courts. In theory, the railroads might force the Brotherhoods to appeal to the courts by refusing to obey the decisions of the Board; but since it appears that the unions do not want to resort to the courts, they merely take a strike vote. Certain rail executives admit flatly that they dare not risk a strike not only because of the stoppage of traffic, but because they fear damages to their property with attendant loss of life.

We get to the subject of taxes next, and, on any basis of analysis, railroad taxes are too high. However, if we rule out social security and unemployment taxes, such impositions

against the railroads have at least flattened out in the last few years. I would indeed be an optimist if I looked forward to a substantial reduction in taxes on any industry or individual, but I have, nevertheless, previously pointed out how an increasing scale of taxation on the roads' chief competitors might put more traffic back on the rails.

Deferred Maintenance

Deferred maintenance is emphasized as a big problem, and at least the dollar amounts spent in this direction might indicate that there is ample room for such a belief. In my own humble opinion, however, I think this is greatly magnified as a major problem. The Interstate Commerce Commission has a very important Bureau of Safety and Inspection. It keeps a careful record of the results of its inspections, and it makes exhaustive investigations of all wrecks. The trends of such defects have been recorded for many years, and comparisons are available which indicate that the railroads have fewer problems due to defective equipment and/or maintenance conditions than they had in 1929. There have been several disastrous passenger wrecks in the past two years, but the one on the "Milwaukee" was due to a washout, the one on the Southern Pacific was explained by sabotage, and the one on the Erie was caused by a head-on collision. Aside from these three wrecks, very few passengers were killed. Moreover, it is difficult for me to believe that there could have been such noteworthy improvement in operating efficiency as the railroads have shown if their equipment and track had been in poor shape. Without being too statistical, we may say that since 1929, gross ton-miles per freight-train-hour (the best recognized criterion of efficiency) increased from 24,539 to 31,138 last year, an increase of about 27 per cent. Train speed also gained more than 25 per cent, and the maximum sustained speed of special streamliners in various sections of the country indicates to me that deferred maintenance, as far as the essential parts of the railroad machine are concerned, is relatively unimportant; or, put it another way, if the railroads should get the volume of traffic which would come from a real upturn in general business they could make up their deferred maintenance as they go along.

Lack of Leadership in the Railroad Industry

A great many investors with whom I have talked feel that the railroad industry is lacking in leadership; in fact, it is no secret that there has been considerable dissension among the principal members of the Association of American Railroads as to the correct procedure with regard to many of the railroads' problems. At the time the A. A. R. was formed several years ago great claims were made that it would put into effect all of the schemes developed by the Federal Coordinator which were really practical. But there has been little evidence of any progress in the direction of pooling or in the coöperative use of many competitive services which, without much doubt, would save the railroads many millions of dollars, and it is not surprising that investors claim that what the industry needs is another Wendell Willkie. They assert further that the control of the larger railroads is so widespread through thousands of small stockholders that the managements do pretty much as they please with little regard to the security holders' interests, and, without much doubt, this is one of the prime complaints of investors against the railroads. On the other hand, there are several reputable organizations whose purpose it is to protect the security holders' interests, and such organizations deserve the increasing support of investors.

Lack of Shipper Coöperation

The shippers, through the tactics of their very aggressive national organizations, have insisted on "eating their cake and having it too". They have fought for a maximum of highway competition and have been opposed to railroad consolidation where they felt this might result in less competition. They have insisted on lower and lower freight rates and yet they are very much opposed to government ownership of the railroads, having seen the demoralizing effects of extension of bureaucratic control over private industry under the "New Deal". They do not relish the thought of the government, through its purchasing policies, influencing the operation of the hundreds of private industries which now supply the railroads with the great multiplicity of things they use. Although they must realize that they are getting the best service they have ever had at constantly lower rates—probably the lowest

in the world, with the exception of Japan—nevertheless, they still feel that railroad management has little conception of their problems. Their viewpoint is pretty well expressed, whether justified or not, in the following resolution adopted by their largest organization a year ago.

> Whereas, it is the view of the National Industrial Traffic League that there is an imperative need for the railroads of the country to acquire a better understanding of the specific transportation problems of shipper industries under the changed conditions which have been brought about through improved facilities and methods for handling commerce by other agencies, and for more intelligent effort on the part of the railroads to adjust their rates and services to meet the requirements of such industries; therefore be it resolved that the special committee on the railroad situation be authorized and directed to communicate to the representatives of the railroads the views here expressed and stress the necessity for more thorough analysis and sympathetic efforts along such lines.

Thus we find dissatisfaction with railroad management not only from the investor but the shipper as well. For the time being anyway the shippers should at least coöperate to the extent of not opposing legislation now before Congress or any other measures which would prevent the railroads from being taken over by the government, and investors through their organizations should use whatever influence they have to bring about a more coöperative attitude between these opposing interests.

Consolidation

Without much doubt there is an oversupply of transportation facilities in the country and consolidation of many competing railroads is most desirable. An important decision of the Interstate Commerce Commission about two weeks ago indicates that there is also an answer to this problem. The Interstate Commerce Commission for the first time in its career permitted the consolidation of two parallel and competing lines in the case of the Mobile & Ohio and Gulf, Mobile & Northern where the main purpose of the merger is admittedly to reduce competition. The savings from such a merger can be very substantial, and it is hoped that a precedent has been established which, over a period of time, will promote many similar mergers with much needed savings to their security holders.

I have discussed the most common reasons why investors refuse to put new money in this great industry and have attempted to point out that there is a long-term solution to each one of these difficulties if the people of the country really wish to have a prosperous and up-to-date railroad machine, and in a moment I will discuss further the steps which Congress has taken in response to the desire of the electorate to establish a national transportation policy which it feels will "promote safe, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers".

All of these problems to the contrary are insignificant when general business activity runs along at the pace of the last few weeks. Not only are the railroads as a whole earning nearly as much as they did in 1930, a good year for the railroads, but many of them are earning more, and it is possible that when the present rush of domestic orders following the declaration of war has been filled, a rearmament program of our own, combined with large orders from the Allies, might take up the slack. However, the bulk of railroad securities are held by sophisticated investors and very few of them are willing to look on the present upturn as anything more than a temporary condition, and their eyes are still focused on these various problems of the railroads. Nevertheless it would be most unfortunate if the present improvement should slow down the activities of those whose efforts are responsible for the remedial legislation now in conference.

Legislation passed by large majorities in both the House and the Senate is now in conference which at least provides, for the guidance of the Interstate Commerce Commission for the first time, a national transportation policy, and it also provides a most decided improvement in the framework within which future legislation may be adopted to correct conditions which I have endeavored to describe. We will not try to go into the details of this legislation for no one can tell how it will come out of conference and be passed in the coming Congress. But there is a serious attempt in both bills to bring all forms of transportation under equality of regulation, and I will, moreover, quote the policy declaration in the Senate Bill, which is almost identical with that in the House Bill.

It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Whether or not the passage of this declaration will promote the interest of the investors in the railroads will depend on how the bill is administered and amended from time to time, but there is at least what appears to be an attempt to do that if the words "promote safe, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers" mean anything.

In conclusion, the war has not yet at least removed the obstacles to private investment and employment in the railroad industry, and for that reason it would be most unfortunate if the sharp improvement in rail earnings to the best levels since 1930 should obscure the need for remedial legislation when it is placed on the agenda of the coming session of Congress.

Remarks by the Chairman

Chairman Morgan: I am sure I may take the liberty of expressing the unanimous gratitude of the members of the Academy and their guests to the speakers for their thoughtful papers delivered to us this afternoon.

Under the rules of the Academy, there is a brief period now allowed for discussion from the floor. Are there any persons who desire to say anything for our further instruction? If not, then I declare the afternoon session adjourned.

PART III

THE WAR'S EFFECT UPON AMERICA'S ECONOMY

INTRODUCTION *

THOMAS W. LAMONT, *Presiding*
Partner of J. P. Morgan & Co.
Trustee of the Academy of Political Science

FIRST of all in behalf of the Academy I want to thank these distinguished gentlemen who have taken part in the day's sessions. We are grateful to them for coming, in many cases long distances, to take part in the important discussions that we have had this morning and this afternoon.

Although you have seen their names, I want to read them once more to show you what a contribution they will have made permanently to the archives of the Academy, when their discussions and addresses are finally printed: Professor Sumner Slichter, of Harvard; Mr. Arthur Ballantine, Former Under Secretary of the Treasury; Dr. Leo Wolman, of Columbia; Dr. Lionel D. Edie; Mr. Mark Jones; Professor John D. Black, of Harvard; Mr. George May; Professor Robert Warren, of the Institute for Advanced Study; and Mr. Edward H. Leslie. And let me thank them once more for what they have done for us.

Because our President, Dr. Randolph Burgess, will never speak for himself, I want to say a word of appreciation for the trustees and for the members of the Academy concerning the work that he has done as head of this Academy. Dr. Burgess is one of those rare creatures; he is both banker and economist. There are only two or three other living combination bankers and economists in captivity. (Laughter) I first came in contact with Dr. Burgess at the time of the long Reparations Conference in Paris in 1929, presided over so brilliantly by Mr. Owen D. Young, whose favoring presence we have with us tonight. Dr. Burgess made a great contribution to that conference.

* Opening remarks at the Third Session of the Annual Meeting.

Just as the World War twenty-five years ago was "the war to end war", so that conference was a conference to end reparations conferences. And it was through no fault of the inspiring leadership of Mr. Young that it failed in its ultimate objectives, and had to go out of the window with all of the rest of Central Europe in 1931. But thank you, Dr. Burgess, for everything that you are doing for us.

May I also add the hearty thanks of the Academy to its Director, Miss Ethel Warner, for the energy, fidelity and discretion with which she has discharged her manifold and complex responsibilities. The trustees on principle are opposed to despotism, but when the despot is a woman and as kindly and benevolent a one as Miss Warner, they are content.

It is a strange world that we are facing in this fifty-ninth year of the Academy of Political Science. I may have mentioned to many of my friends here, the conversation I had some months ago with H. G. Wells in London. I said to him, "Where do you expect to be ten years from now?" And he replied, "Either dead, or in an asylum for the sane." (Laughter and applause)

Everything seems to have gone topsy-turvy, everything awry. Hitler has turned into Stalin, Stalin into Hitler, and what not.

Well, here we are, in November; the World's Fair for the time being is over. The football season has begun. I really introduced the topic of the World's Fair in order to tell my experience at the Chicago World's Fair in 1933 which is, again, not particularly new. But you recall that in the spring of that year Chicago made a great to-do over being able to secure the loan of Whistler's Portrait of His Mother. The Middle-Western papers had a great deal to say about that, and it was very considerably exploited.

The first day I visited the Fair I went to the Museum of Art where all the pictures were, and I said to the doorman as I went in, "What picture is it that people are asking most to see as they come in?"

"Oh," he said, "they all want to see Hitler's picture of his mother." (Laughter)

And that, as I say, leads us to the football season. (Laughter) President Conant was telling me this morning about a football game that he heard of last week. The eleven of the University of California went down to Southern California to play a team there, and to their surprise, although not consternation in any way, they found seven out of their eleven opponents were Negroes—very nice fellows.

On the first play for the University of California the halfback tried to run around the right end, but he was thrown for a loss. He struggled to his feet through this dark, Erebus-like line, and then he tried to run around the left end. The same thing occurred, and again he was unearthed from a great lot of dusky warriors.

Then he tried the center, and got through a couple of yards. And when he got up he was so surprised to find it was a white center who had tackled him that he eagerly grasped his opponent by the hand and said, " Dr. Livingston, I presume? " (Laughter and applause)

And so, you see, by natural stages we come to General Johnson! General Johnson, frantic messages were coming to the head table all the evening about your failure to appear. There were no less frantic messages concerning Miss Thompson, for a while, but she relieved our anxiety earlier in the game.

I do not have to tell you of the extraordinary career that General Johnson has had, and how varied that career has been: a lawyer, a soldier, an industrialist, a commentator, and I don't know what else besides—a very extraordinary, all-around training.

I do not agree with everything that the General says at all times, but I must acknowledge that he speaks with a voice of honesty and candor, and with true conviction. And I want to say this, that when ten thousand years from now they are unearthing here on this earth the vestiges of the New Deal (laughter), just as our Museum of Natural History has been unearthing vestiges of the ancient creatures in Mongolia, one of the archeologists will come along and find Hugh Johnson's thigh bone, and they will reconstruct Hugh Johnson. And in that reconstruction they will find not that he was one of the lesser animals, but that he was a real mammoth, or a dinosaur! (Laughter)

With that brief introduction, I present to you, General Hugh Johnson! (Applause)

THE WAR'S EFFECT UPON AMERICA'S ECONOMY

HUGH S. JOHNSON
Radio and Editorial Commentator

I UNDERSTAND the general topic of this discussion to be " The Effect of the War on America's Idle Men and Idle Money ". If that refers to a war in which we are neutral, there will still be idle men and idle money. If we get into a new world war on any such magnificent scale as we were preparing in 1917 and 1918 there wouldn't be an idle man or an idle dollar in the United States—for a little while. After that, the question to you would be like the darky in jail who asked his friend in the street, " What time is it? " The answer was " Whaffo yo' want to know. You ain't gwine no place." You don't need to worry about dollars in such an event. You won't have any. And in the same shrewd Negro language—as to idle men—there won't be nothin' else but.

Woodrow Wilson used to talk about the four " M's" of war —men, money, material and morale. It was a trite but good analysis. Wars used to be fought between relatively small fractions of the strength of belligerent nations. It was a sort of glorified football game in which the people pretty much sat in the bleachers while more or less professional military teams placed themselves between the two capitals and then feinted, bucked the line or forward passed—as Napoleon did in Italy—until one side or the other had been outsmarted or out-punched.

The Germans invented the idea of " the nation in arms ". It was substantially—" if national existence depends on a test of arms, why should anything less than the whole national strength be enlisted in the struggle? " The change caused by that idea was partly due to the thought itself and partly to the enormous improvement in means of transportation and communication and the scientific development of the so-called industrial revolution.

Your history says that Xerxes marched toward Greece with an army of a million men. We know that this was poetic license. We know it from the geography of those battlefields and their means of transport. Up to the last fifty years it would have been impossible to transport or supply, anywhere on the earth's surface, a field army of a million men in any single group.

In the World War, Pershing had 2,000,000 in France but to do that we had to marshal all the loose carrying trade of the seven seas, rebuild all the southern ports of France, double the French railroads to our front and engage in an industrial *tour de force* that among other changes eventually cost us nearly fifty billions gross.

The German idea of the nation in arms carried to its logical conclusion means that the whole nation must become an army. As President Wilson said in his draft proclamation, "the men who remain to work the factories and till the soil are no less a part of the army that is in France than the men beneath the battle flags. It must be so with us. It is not our army that we must train and shape for war. It is a nation."

The production of every section of possible tillage land as well as the output of every tin-pot machine shop becomes as important in this kind of universal effort as the raising and arming of a company of infantry.

The battle effort itself has become a dreadful thing. The weight of metal and chemicals necessary to drench whole landscapes in splintered steel and gas has multiplied in possibility —and therefore, in necessity. The expenditures of artillery and small arms ammunition in the battles of the Somme in a single hour were many times greater than that of our great battles of the past in a whole week. The battlefield of Gettysburg is seven miles long. The Western Front extended from the Vosges mountains to the North Sea—heavily manned and gunned in every mile.

Nations have learned too, what used to be neglected, that the morale of the civilian population becomes as important as the morale of the army in the field. Ludendorf's most bitter complaint was that through starvation and deprivation, his home front crumbled long before his military front gave way.

In other words, this vast new flood of supplies that must be gathered in overwhelming reservoirs to inundate thousands of square miles of battlefield with destruction must somehow be obtained without depriving the home-folk of an ample supply of all necessities of life.

Since whole nations are armies, this deprivation of an enemy's population—women, children and the aged—is a prime purpose of warfare. Mutiny behind the enemy lines is a major aim of modern strategy—mutiny induced by economic strangulation. Blockade their whole nation, strangle and starve it. Enlist all four horsemen of the Apocalypse—including pestilence through malnutrition—not merely against men at arms but against the whole enemy people. Permit not a preventable ounce of any useful thing to cross their borders.

You don't need any blue print of these tactics. Mr. Wilson's principal plea, as is the Allies' today, was that we were making no war on the German people—only on their hateful rulers. We invited them to revolution. Meanwhile, we brought every pressure that ingenuity and economic power could invent or apply to starve those people into discontent and incite them to mutiny—exactly as the Allies are doing today.

It isn't pretty but it is war—and when Sherman said that war is hell he didn't know the half of it. We understood frightfulness as early as 1864. Sherman destroyed Georgia to that end. Sheridan left the Shenandoah in a state where he boasted that a crow couldn't fly it without carrying his own rations.

As Hindenburg said of our effort—"Her brilliant, if pitiless war industry had entered the service of patriotism and had not failed it. Under the compulsion of military necessity a ruthless autocracy was at work and rightly, even in this land at the portals of which the Statue of Liberty flashes its blinding light across the seas. They understood war."

There is not sympathy nor chivalry nor humanity in the military art today. It is coldly scientific murder and destruction—not merely of men at arms but of the very body and spirit of the people at home.

I cite all this morbid realism to emphasize a single thought—that war is no longer merely a professional contest between armies. It is a grapple to the death between whole economic systems in which that nation is most likely to win which can deluge its enemy with the greatest tonnage of production prepared for destruction and shut off from it the greatest stream of supply for the daily living of its people.

That is why I began by saying that if by any crazy blundering we get in again, on any such basis as we were preparing in 1918, there will be neither idle men nor idle dollars in the United States—not while the war lasts at least. There is no question of not enough consumption at such a time. The capacious maw of war gulps all that you can throw down it and asks constantly for more.

There was not a single element of American production in 1918 for which we could find half enough to supply the insatiable demand. It is true that the sudden armistice proved that not all demands were justified. But in such a war you cannot excuse anything less than maximum effort. The slogan was "Fight as though the war could be ended tomorrow. Produce as though it would last ten years."

There were no idle men. It is usually said that we raised 4,000,000 men for our armed services. The fact is that, between the beginning and end of our participation, more than 6,000,000 had in one way or another been taken from the ranks of normal civilian employment. How many were employed in abnormal war production, there is no way of telling. I can only say, from my experience, first, in charge of the draft, and then as army member of the War Industries Board and chief of all army purchase and supply, that in the summer of 1918 man power had already become a serious problem.

We adopted the "work or fight" order as an indirect means not only of driving all men out of idleness, but also as a means to tap the supply of our women and put them to work in every job in which they could even passably do the work of men.

Neither were there any idle dollars. The necessity to direct every cent available for investment into fields where they would best serve the common purpose had become so great that we set up a Capital Issues Committee which refused the use of the diminishing flood of available capital—whether by loans or investment—to any purpose which could not show a direct contribution to the winning of the War.

Notwithstanding a 217 per cent inflation and an unchecked flood of public money into private industrial production, there simply was not enough capital to finance our needs. There were yawning shortages in all of Mr. Wilson's four "M's"—except one. We kept up our morale, but the supply of men, money and material was so short that we had to ration each to the greatest need.

Taken all in all, it was perhaps the busiest period for both men and money that this country has ever seen. If we get into a new war on anything like the same scale there will be neither idle men nor idle dollars—at least "for the duration".

I take it that my subject does not call for any remark as to just where that kind of activity leads. Yet it is hard to resist one or two observations along that line. It is usually said that our gross war costs were 49 billions—and our net costs about 39 billions. Those net figures deduct from the gross costs the war debts of our associates. You know what they are worth.

It is tempering the bad news to say that the gross direct cost was 49 billions. We had not anywhere near reached our stride. In 1918 we spent about 19 billions. The United States Treasury estimated the 1919 cost at 24 billions. But Mr. B. M. Baruch with better information of the 1919 industrial plans has guessed that the cost for that year alone would have been nearer 35 than 24 billions. I note that the National Economy League has just estimated a year's cost to us of another major war in Europe at 30 billions of dollars. From my experience, the facts I have just given and my own studies I am sure that figure is not too large. We could reach no such rate in twelve months, but if we enter a protracted war it is sure to cost that much each year.

Equipment and supply for war cost much more now than then, due to greater mechanization and mobilization. British authorities have stated that it costs twice as much to equip an infantry division. My own guess is much higher. Our old type of infantry rifle cost about $17. The new Garrand will cost at least $100. World War airplanes cost $5,000 to $10,000. New pursuit and observation planes, on recent published army contracts, cost $25,000 to $45,000, and new giant bombers from $60,000 to $150,000. Increased calibers of guns of all types—vastly increased rates of fire—will not merely double costs, they are apt to square or cube them.

I saw a newspaper statement that the British were prepared to spend 60 per cent of national income for war—around 20 billions a year. In our case that would certainly exceed 30 billions. Our 1919 expenditures exceeded theirs by more than 50 per cent.

You can only get dizzy juggling these astronomical figures; but you can remember that we entered the World War with relatively insignificant debt and federal taxes. We would enter a new one with between 50 and 60 billions of debt and almost unbearable taxes.

Considering the existing staggering total of state and local taxes, if we entered a new universal war on the scale to be expected of us, we could hardly count upon a federal revenue of more than 10 billions at an absolute extreme. We could be increasing our debt, on the British estimate and our own experience, at from 25 to 30 billions a year.

How long could this last—starting from scratch with say 60 billions of debt? I do not know the answer. According to a very eminent authority, "Taxes are paid in the sweat of every man who labors. They can be paid only in production and are a first lien on production." They could be a burden so heavy that every man who labors would be working one day for himself and three days to pay for the burdens and blunders of government.

Government exists only in the totalitarian states on the theory that men exist for government—not, as with us, that governments exist for men. If and when we reach any such condition as that when a man works two days out of three, or three days out of four, for government, we have reached the end of individual freedom. We are in a condition of slavery to the state—the aim of Stalinism and Hitlerism—the antithesis of the purpose of the American system—the end of individual freedom.

It is apparent also that the charge of federal and local debt and taxes lies as a first lien on every ounce and inch and cent of value of every individual property in the United States. What is our national wealth? Estimates vary, depending on conditions, between 280 and 400 billions. Against

that now lies a total gross public debt—federal, state and local—of 60 to 65 billions. A very few years of our engagement in a major modern war at 30 billions a year could simply wipe out the capitalist and profits system in the United States.

There would be neither idle men nor idle dollars in a new major overseas war, but at the end of it we would find a condition that would make February 1933 look like prosperity.

I do not wish to exaggerate in any alarmist tom-tom beating. I do not say that any such crazy national suicide will happen. I believe that it will not. I am only suggesting that when John Marshall said that the constitutional power to tax involves the power to destroy, he knew exactly what he was talking about and that our new engagement in a modern major war on a 1918 model could easily destroy completely the American capitalist and profits system and our devotion to the idea of individual freedom. It could do it without any revolution, without any change to communism, without anything more than an appeal to war-time patriotism and our will to victory forcing us to the unlimited expenditures of modern war.

There is one possibility of war in which we might still have both idle men and idle dollars—and also probably lose the victory. There are proposals now before Congress—even if they are unlikely to pass except in some spasm of war-time emotion—which would effect this in a trice.

There are proposals, such as Senator Josh Lee's for an immediate capital levy, to require every property holding above $1000 to buy government bonds, pro rata and practically without interest to pay the current costs of any war. There are others, such as those advanced by Senator Nye to confiscate not merely profits due to war—which most of us favor—but practically all profits and all incomes in the course of war—which is a very different thing. There are proposals, upon the advent of war, to turn all operations of industry over to government—to put industrial management under military law. Add all these proposals together and you get exactly the idea that haunts all the communist and socialist theory yet presented—"production for use and not for profit"—state socialism—government ownership and direction of all human economic effort.

Maybe it is good. We only know that it never yet has worked since the beginning of time—though frequently it has been tried. We only know that the system to which we have been devoted—faulty as its working has sometimes been—has peopled a continent with the happiest and best provision for the common people that has ever been known in the history of the world.

It would not seem to be the part of wisdom to depart from it even in times of the profoundest peace. But how about departing from it in time of war, with an enemy knocking at our very gates?

I have tried to show what I believe to be incontestable, that modern national military effort is nothing less than the utmost in industrial effort. In what case where would we be with the acknowledged superior industrial system on earth, suddenly upon the advent of war to adopt an economic control and philosophy not only utterly experimental and untried but also adverse to every principle which we have tried with such conspicuous success—where would we be if we suddenly adopted a communistic form for industrial production at just the moment when we need maximum production? It would paralyze production and defense. It would at one stroke destroy individualism and our capitalist and profits system. It is incredible folly, but there is a panicky passion for war experimentation in our midst. It does not stop very long to consider practical results.

We can see an example of this in the Pittman Act. By unnecessarily getting off the ocean without sufficient study of how to get off best and without too greatly upsetting an existing system, 9,000 of our seamen and stevedores seem about to lose their jobs and 600,000 tons of our ocean shipping is to be tied up at the docks. Barring some such blunder as these new brain storms contained in some of the war bills, there will be no idle men or idle dollars if we get into a continuing world war on a modern scale.

But what if the war goes on and we stay out? What will be the effect on unemployment and our frozen turnover of money? I think that directly it will be very slight at first. The warring nations have far greater reserves of materials than in 1914. They have become much more nearly self-

contained. Except for airplanes and perhaps motor transport we have nothing of armament to sell them.

The duPonts were the advertised devils of the last war. They were largely a powder company then. Today not 2 per cent of their capacity is in that field. Every ounce of it will be needed for our own armament program. We have no gun or small arms factory capacity that we shall not need for our own reëquipment. Our shipyards are crowded and booked far ahead with orders. There, perhaps, will be some secondary demand for steel and chemicals—the raw materials of shells—and possibly for guns. But the release of any 1916 flood of war orders for everything we produce is most unlikely. Europe is no longer dependent on America for nitrates or copper and not nearly so greatly dependent on the United States for food and fibers.

Certainly so long as the war remains in the present static state the monstrous consumption of 1917 and 1918 will not occur and I can see no possibility of any such abnormal demand on us.

A review of our limited armament capacity makes it quite clear that we could furnish arms only by a great extension of specialized plants which are of limited use in peace. There is no disposition among our industrialists to take the dangerous risk of this kind of extension again. I know of no manufacturer who wants any armament business.

Neither does labor want it. William Green and John Lewis have lived through a war labor boom—and what came after. They are both emphatically on record as against any kind of repetition of that nightmare.

I believe that this war is not going to employ directly large numbers of either our idle men or idle dollars—not by our getting into it because we must not get in—not by our staying out because there is not apt to be any sufficient demand directly to employ our millions of idle men or encourage the investment of our billions of idle dollars.

Indirectly—if we keep out of it—the war could much improve our condition. We should increase our trade and establish our goods in many countries which warring nations can no longer serve. If the war drags out, it could possibly leave us the only strong and solvent nation on earth with our war-shattered competitors, on both sides, bankrupt and impotent.

Ours could become the dominant voice for a restoration of decency and democracy on earth. It could turn out to be the task of American capital and labor to restore a ruined world and perhaps thus—both for us and for them—to build on a firmer and better basis a sounder prosperity than we or other nations have ever known.

That is a possibility of our staying out with restraint and generosity. The chief possibility of our getting in is to dilute our strength with the world's weakness—to get down into the welter of hatred, bloodshed, bankruptcy, destruction and ruin that might wreck the last stronghold of Western civilization and—no matter what the final outcome—still further risk and burden all that we and our fathers have built up on this continent in 320 years of labor and privation.

There is little that we could now add to either side in getting in. There is much that we could lose for ourselves and for the whole world by not keeping out. If there ever was a time when both material and spiritual interest dictated the course of American neutrality, it is now—we must keep out of war. (Applause)

Remarks by the Chairman

Chairman Lamont: We thank you heartily for this stirring, this vigorous, this illuminating and appealing address, General Johnson. We are grateful to you for coming over to us from Washington, taking this journey and letting us have your words at first hand, face to face, in your own vigorous way. My only disappointment, General, is that you did not indulge in a little rougher language. (Laughter)

General Johnson: Well, I can still do that.

Chairman Lamont: Before I introduce Miss Dorothy Thompson, I am going to ask one of our foreign visitors to bring us a brief word of greeting. We have with us tonight two distinguished former Prime Ministers of Belgium, my friend Georges Theunis, and Dr. Paul van Zeeland. (Applause)

My friendship with Mr. Theunis goes back to the days of the Peace Conference in 1919, when the American delegation fought, as well as it knew how, to establish with their Belgian friends the priority in reparations for Belgium. This was accomplished. Mr. Theunis has had a distinguished career since then and served his country well.

Dr. Paul van Zeeland has been more recently favorably known to these shores because of his great efforts toward the expansion and stabilization of international trade, and now he is over here in connection with the refugee problem. I am going to call upon him to say just a word, whatever comes to his mind. I want to assure him and Mr. Theunis of our heartiest welcome, because we realize that both of them, with their countrymen, have been under especially severe anxiety in the last few weeks. Dr. Paul van Zeeland! (The assemblage arose and applauded.)

GREETINGS

PAUL VAN ZEELAND
Former Premier of Belgium

I HOPED to the last moment that Mr. Lamont would forget to call upon me, even for a short greeting, because it is too difficult for a man in my position to address a public audience in this country right now. You can imagine what a week of anxiety we Belgians have been living through; the position of our country is so delicate that I would be afraid that a single word, wrongly expressed or wrongly understood, might really be harmful to our fatherland.

You see, the same words sometimes cover very different realities. Both the United States and Belgium are neutral in these circumstances, but it is surprising to see and to feel what a difference in that neutrality results from the fact that on one hand there are 130,000,000 people, on the other hand, only 8,000,000 people.

Also, what a difference it makes to have between certain people and your country on the one hand, a thin, theoretical international border, and on the other hand, a few thousand miles of ocean. (Applause)

So I thought I should refrain from expressing my views. But Mr. Lamont—you know how clever and how keen he is—said to me, "Well, don't speak—just greet your friends." Thus I had to say, "Yes." But I cannot really talk when I have not the possibility of expressing what I think.

I will, as a matter of short greeting to you, merely emphasize one thought. I am of a generation which has really been subjected to great hardships. I was twenty when I went into the army for the World War. I was in business when the economic crisis came. I was in politics when the big political crisis came. Now I have been living through a week, not knowing at any moment whether I would not have to take my ticket on the Clipper to go back as soon as possible.

In spite of that, I am not ready to become pessimistic, and to give in. Of course, we have many reasons to be anxious concerning the future of mankind. We have witnessed in recent years, the last fifteen, an extraordinary deterioration of human standards, and we are now in the midst of a crisis the issue of which no one at this moment can see.

Nevertheless, I believe that after this crisis, we may again have one great opportunity. Surprising as it may sound, I have been able to find in authoritative circles, new reactions to the big problems concerning the future of mankind.

I have been devoting myself for years to ideals which purported to ameliorate relations between nations, in economics and politics. For quite a while, many of the ideals I believed in were considered Utopian by so-called realistic people. Well, now, since the worst has come upon us, I have found that many people have changed their minds, and that they are now ready to accept ideas much more radical than those we were able to recommend before.

I think that this is already one evidence of progress, and I hope that the time will come after the war when it will be possible to seize again the great opportunity that we missed after the World War.

I hope that at that time the United States of America, whose place in the world is so big, will share the responsibility of it.

When I listened to the illuminating speech of General Johnson, I felt within myself, "How lucky you are, you who have, or think you have, the choice between war and peace." For many countries, this choice, unfortunately, does not exist.

But in spite of everything, I hope that after the present war a time will come when we will be able to realize conditions in which the exchange, on all sides of the frontiers, of men, of ideas, of goods, and of capital will be freer, for the good of everybody in the world. (Applause)

REMARKS

CHAIRMAN LAMONT—We thank you, Dr. van Zeeland, for this very inspiring message, and we reciprocate every sentiment that you give to us.

We are especially grateful tonight to Miss Dorothy Thompson for having left a sick-bed in order not to disappoint us. We were under grave apprehension at noon, but heaven smiled upon us, and Miss Dorothy Thompson is here. And, if she will permit me to say it in this presence, to look at her we shouldn't dream she had ever been within a thousand miles of the grippe!

This dinner tonight is going to omit the usual practice which has grown up in New York of giving a gold medal to Miss Dorothy Thompson. You know it has become almost a custom, wherever two or three are gathered in New York, for someone to say, "Well, let's get up a committee and give Miss Dorothy Thompson a gold medal." (Laughter)

That is all perfectly true, and also it enables me to give the only statistics with which I shall burden you this evening. We are at a dinner of the Academy of Political Science, but I am neither an academician nor a politician nor a scientist, and I am not familiar with figures. (Laughter) That is true, perfectly true.

But I had an engineer figure out for me the other day the space that all the gold in the world, all the coined or bar gold (and I don't mean to include earrings and wedding rings) would occupy. To my surprise, after carefully figuring and rechecking, he reported it would occupy a cube only thirty-six feet by thirty-six feet. Well, now, of that cube we have, roughly speaking, five eighths or two thirds buried in a hole in Kentucky. And I was thinking how curious it would be and, really, how funny it would be, if we continued to suck and drain all the gold of the world to these shores so that we had it all, and if then, when the war was over and every other country was impoverished and we had all the gold, the other countries demonetized gold and we were left with it all on our hands. The only amusing thought is that then Uncle Sam would have been the innocent victim of the greatest gold-brick game ever known to civilized man. (Laughter)

GENERAL JOHNSON: Think of how many medals that would make for Dorothy! (Laughter)

CHAIRMAN LAMONT: That is true enough. But in my remarks about gold, pray do not take me too seriously. I am not for a moment predicting that gold will go out as a basic measure for world currencies.

Miss Thompson, we greet you tonight. Some people have said to me: "I think Dorothy Thompson is wonderful, but she is so emotional." Well, I thank God that Miss Dorothy Thompson is emotional (applause), because she is moved by righteous causes; she is moved by pity for the oppressed; she is moved by an ardent desire to succor those who are in ill fortune.

I hesitate to say this in her presence, but I should like to have all members of the Academy and their friends know how much of a factor in American affairs, and how great an influence Miss Dorothy Thompson is, and wields, and how glad we are to have her with us tonight. Miss Thompson!

(The assemblage arose and applauded.)

MISS THOMPSON: Emotionalism, Mr. Lamont, says a lady in a cold, icy voice, is what one calls the arguments of one's opponent. (Applause)

General Johnson is always very stimulating to me. I read him in the afternoon, and then I write the next morning, and I am enormously grateful to him because he often stimulates me to controversy, and sometimes to agreement.

I agree with you, General, that we should keep out of this war. It seems to me, however, to be at the moment a fairly academic question. As far as I know, nobody wants us to go into this war. As far as I know, nobody has asked us, and I certainly do not know where we would go, if we started to get ready to go. Maybe we will be asked to go to Finland; I do not know.

On the other hand, in thinking about this war and the issues in it, and the effect of it on the United States and on the world at large, I am afraid I do not think that there is such a thing in the world (to quote you, if I may, General) as "a single strong and solvent nation" emerging from a bankrupt world.

It would seem to me that that is what we have learned in the last fifteen years, that there "ain't no such thing" as a single, solvent nation, that somehow or other the world must again be solvent and strong, by and large, or else it is going to be very bad for us.

And when I think about the war, which like all the rest of you I do about twelve hours a day, the primary question that always concerns me, makes me try to look back over the past, is the question of why we have got a war—at least, why Europe has a war, why there is a war at all.

(Miss Thompson then read her formal paper.)

THE WAR'S EFFECT UPON AMERICA'S ECONOMY

DOROTHY THOMPSON
Columnist, Radio Commentator and Author

THIS war occurred for a great many reasons. It is necessary to separate those reasons, to weigh each of them according to its proper evaluation. Because if we do not do that, we shall go on making very serious mistakes about the world that we live in. We shall go on making the same mistakes that other nations have made and that we have made in the past. And if we make those mistakes, then sooner or later we, too, shall pay for them.

It has been the custom to say in the last few months that this war is a result of the Treaty of Versailles; that Hitler and National Socialism were produced by the Treaty of Versailles; that this war is a struggle between have and have-not nations. This is partly true. The Treaty of Versailles created a psychosis in the German mind. But the Treaty of Versailles was already as dead as the dodo before Mr. Hitler ever became the leader of Germany. The reparations bill had been wiped out, without a cent of it ever having been paid. That is to say, it was paid by the amazing financial system of the nineteen-twenties whereby the United States lent money to Germany to pay France to pay Great Britain to pay the United States to lend money to Germany to pay France, etc., and ring around the rosy.

All this went on because the people of Europe and the United States were unwilling to grasp the simple truth that a major war in the twentieth century is a net loss, and can never be paid for—by anybody. As a matter of fact major wars have never been paid for in history. The debts of the Napoleonic wars were never paid. Little wars like the Franco-Prussian war in 1870 could be paid for. That was a quick war, over in a few months, before the economic structure of the contending nations had been completely disrupted, and before the financial structures had been inflated out of all

conscience. But a war of the proportions of the last one has to have its debts wiped out. Each generation must pay for its own wars. The succeeding ones will not.

The injustice done by the Treaty of Versailles, and the other treaties, was not an injustice done to Germany. It was an injustice done to Europe and to Western civilization. It was not an evil treaty! It failed because the men who made it did not know the essential facts about the world in which they lived. They were men who were still thinking in terms of the nineteenth century. They were still thinking in terms of power politics, of the balance of power, of nineteenth-century liberalism and nineteenth-century nationalism.

They thought of democracy in purely political and legalistic terms—parliamentary government, republican structures, self-determination for small nations. They made a League of Nations, not a League of Peoples, which is a very different thing. They abandoned the kind of peace that had existed from 1812 to 1914. That was an enforced peace: the Pax Britannica. It did not prevent wars, but it did prevent a world war. There was no world war for one hundred years preceding 1914. The peace of the world was kept on the terms of Great Britain. The naval and financial power of Great Britain was enormous. Her long purse, her naval bases throughout the globe and her willingness to use her power meant that she was in a position constantly to hold the equilibrium. She allowed adjustments to be made, sometimes by force. In those hundred years, there was the Crimean War, the Spanish-American War and the Russo-Japanese War. But there was no world war, because Britain could always throw her power into the balance in such a manner that somebody backed down. And in those hundred years, Britain maintained a policy of free trade and free money—that is to say, a truly capitalist system. She kept an open world.

In 1918, after the World War, Great Britain was no longer strong enough alone to enforce peace, nor to finance the world. The strongest nation in 1918 was the United States of America. The financial and economic power of the world had passed from Great Britain to the United States. We were potentially at least the greatest naval power in the world. Had we wished to use our power, had we had the courage to use that power;

had we been willing to accept international responsibility—to share it, for instance, with Britain and France—there could have been world peace for another hundred years, and a new blooming of capitalism. (Applause) I am not saying it would have been a just peace or the best possible social system, but peace could have been kept on the terms set by Great Britain and the United States, and prosperity could have been multiplied.

Instead, we washed our hands of this responsibility, came home from Europe more or less disgusted and disillusioned, and left Europe broke and with the League of Nations. The League of Nations was a noble attempt to organize the world. The fact that it failed does not mean that the world cannot and must not be organized. It can be and must be. But it is impossible to organize the world at all without the United States, and it is impossible to organize Europe, or any other continent, without the relinquishment of a certain amount of national sovereignty.

The League of Nations was an association of sovereign governments—any one of which had the right to secede. Had we joined it, it would have been a world league, but one in which too many problems were lumped together. The League had no implements of force with which it could insist on its programs being carried out. The League could demand sanctions, but it could not enforce its demands, and so it was doomed to failure as every other league of sovereign states had been doomed to failure in the long run.

But furthermore, and this seems to me the most important, post-war Europe failed to do anything at all, in an organized way, about the fundamental problem, namely, the problem of economics. The problem of Germany, France and Britain, and of the United States as well, is the same problem. It is a problem of work and bread for human beings. In Western Europe and in North America are concentrated about the whole of the science, technique and industrial production of the planet. In Europe live 400,000,000 people. The industrial and technological production is dependent upon sources of supplies outside Europe, and upon the highest development of the European market, and of the outside market. Economically, Western Europe and the United States have the same basic

problems. Economically, European nationalism needs profound modification and needed it in 1918. But the peace treaties, instead of modifying nationalism by breaking down both the political and economic boundaries, accelerated and intensified it, all on the high-sounding principle of the rights of self-determination of small nations, and this intensification of nationalism was assisted by the tariff policy of the United States.

The peace treaties, for instance, ratified the break-up of the Austro-Hungarian Empire. It is true that the Empire was decadent, the bureaucracy top-heavy, the ruling classes rigid. But it is also true that the Empire held together the scramble of races in the Danubian basin, and was an almost perfectly balanced economic complex. This great complex had free trade within its borders, had a common currency, and supported only one armed force. After the peace treaties it had a welter of currencies, tariff walls around each little country, and an army for each of them.

If the Allies win this war and again refuse to face the essential problem of Europe, which is economic and which demands universal coöperation, then Europe will be delivered over to revolution and anarchy.

I do not believe in any such dismal future. I do not believe that civilization is about to perish. (Applause) On the contrary, I believe that it is about to begin again. The only people in Europe today who are doing any constructive thinking know that this war is not going to be settled by the rehabilitation of Poland, but only by the rehabilitation of all of Europe. Europe, to avoid the anarchy of the last twenty years, must be one kind of thing when this war is finally over. It must have one ethic, one form of economic structure, and a universal basis in law. That unity is either going to be imposed upon Europe by the Nazis, or it is going to be constructed in Europe out of the best things in the European spirit. I believe the latter is going to happen. I do not see nazism or communism as the forms of the future. I think they are the results of a collapse. They are not the beginning of a new era, but the end of an old era.

What we are seeing in this war is the death throes of an epoch. An age is dying. We are definitely at the end of an era of human history. One of its characteristics is that an alarmingly large number of our political, intellectual and business leaders, here and in Europe, still seem blissfully unaware of the fact. They still hope for a return to the placid conceptions of yesterday. This complacent lack of awareness turns into extreme jitters if it is rudely disturbed, as it has been by this war. In this country the reaction is to try to ward off the evil demon by saying the war does not affect us, and that if we stuff cotton in our ears and close our eyes, and above all hold our tongues, the issues in this war will never reach our shores. This is foolish, because the issues have been on these shores for a long time. Here, as in Europe, the road that our civilization has been taking for the past century has reached an impasse. The problems which we have to meet and solve are not intrinsically different from the problems of Europe.

Here, as in Europe, the concept of democracy has got to undergo a thorough overhauling. This European war is an incident in the European revolution. Europe is in a full state of revolution. That is the first and last thing one must remember about this war. Whoever wins it, the social structure of Europe will never be the same as it was before it began. And though we shall in all probability escape the war, we shall not escape the revolution.

Let me say that I do not mean by revolution—or do not necessarily mean by it—rioting, bloodshed and civil war. I mean by revolution fundamental overhauling of the social and economic structure. I mean by revolution the creation of new standards, new frames of reference, new concepts of community life, new forms of political and economic activity. Just as the war in Europe is being fought to determine how four hundred million people are going to live on that continent—in what form of society—so we in the next two or three decades are going to have to discover how 130,000,000 of us are going to live on *this* continent.

Europe, it seems to me, has got to rediscover and find new terms and new modes of expressing the idea of Europe, the unity of Europe, and for assuring the economic well-being of the people of Europe; and the United States has got to find new terms and new ways to express the idea of America, the

unity of America, and the economic well-being of the American people.

I do not think there will be so much difference, in the long run, between the new Europe and the new America. We do not like to think of it these days, when we prefer to consider geographical distance rather than the ideological nearness of the United States to Europe. But the truth is that we are all children of Europeans; that this country was built upon European ideas; that without Aristotle and Montesquieu and Locke and Hume and Magna Charta and the British Constitution and the French Encyclopaedists, this country would not exist in the form it does. We are an integral part of Western civilization. Our greatest contribution to political history has been the idea of federalism. There are more Europeans reading *The Federalist* at this moment than have read it in many years, and I am inclined to think more than are reading it in the United States.

Every European idea has had repercussions in the United States. We have our Marxians, our Freudians and even our Fascists. The New Deal has been chiefly a replica, and not a very good one, of social legislation and government control long since exercised in Europe. We have the same line-up and the same conflicts inside society as Europe has. We have the same economic problem of how to use our labor, resources and technology to produce a stable and improving economy.

We have, in fact, the same kind of a social system in almost the same state of decadence, and the decadence shows itself in the same way.

If I may make an aside, what are the symptoms that an old era is dying and a new one is trying to be born? I should put first among them the decay of the concept of democracy. The original idea of democracy is a profoundly religious one. It rests in a belief in the sacredness of the human soul, as a Child of God and as a joint heir to the Kingdom of the Spirit and to the fruits of this earth. The object of democracy must be humanistic; I mean by that that the first business of a democracy is not to create " prosperity ", or to build the longest bridges or the highest buildings, or to acquire the greatest national power. Its first object must be to create the largest possible number of fully conscious, self-possessed, happy, healthy, free human beings. A successful democracy can never be measured in terms of the national wealth in dollars, or the number of cubic feet of gold in Kentucky. It can only be measured in the quality of the human beings it produces.

But the Communists are right when they say that no one can exist as a *person* below a certain minimum economic level. The development of the finer traits of courage, self-reliance, generosity and spiritual poise which mark the truly superior human being is all but impossible under the conditions in which our poorer workers live today, in this country as well as elsewhere. At the worst, they are homeless, disease-infested, dirty, unwanted nomads, like the migratory workers, ten thousand of whom are herded at this moment in California camps, or the tens of thousands of derelicts of city slums—the children of Dead End Street.

But at the very best the worker for wages lives a life of constant insecurity, under the constant threat of humiliation. He is without security in his property, the property which is his life, that is to say, his work. Under the capitalist system, labor is a commodity. A man's life is a commodity; the work that produces his own food and the food and shelter of his wife and children is a commodity to be bought and sold in the open market, according to the law of supply and demand. What determines whether there is a market for this commodity, which is the human life, is solely the question of whether the employment of that commodity can return a certain increment upon a money investment. It is the profit on a money investment that determines whether a man may be allowed to live. This means that money has the right of reproduction, but human beings do not.

Given international peace, and a freely functioning world capitalist economy, this system might, nevertheless, produce so much wealth that it would be justified in the popular mind. But in the last twenty years we have had neither a logical capitalism nor any form of intelligent socialism. Capitalism has not justified itself in human terms and the social result of the domination of society by money—by the right of money to increase without effort—is the degradation of the whole of society, including standards of work, an attitude of irresponsibility on the part of the worker, lack of pride in work, lack

of joy in work. The worker himself has adopted the attitude of the employer—why should he not? If work is a commodity, the value of which is determined by the market—and by an ever-diminishing market—then the worker is just a trader in the commodity, and his business is to get as much as he can for as little as he can give.

This concept of work is of something *sold* rather than of something *done*. The degradation of work to a thing of barter degrades the whole society. There is no concept of a contribution to the whole community of work; no feeling of being an irreplaceable part of something; no feeling of reciprocal obligation to society as a whole. And so the concept of democracy degenerates into a wholesale scramble for privileges.

The complacent attitude is that this profound discontent of workers can be bought by a dole, relief, a sort of social-settlement, lady-bountiful attitude on the part of the state. They are wrong. You cannot buy off this discontent. It is too deep. It is rebellious against a fundamentally undignified human position; and this rebellion has been exploited by demagogues into the various forms of slavery plus social security which are now being tested by war.

These totalitarianisms have destroyed the tyranny of money to set up the even worse tyranny of force and national glory. The worker in the decaying capitalist state is a vagabond essentially; the worker in the Communist or Nazi state is a slave; perhaps—I hope—the worker in the coöperative commonwealth of tomorrow will be a free man with a definitely guaranteed stake in the industry for which he works, with a recognition of his property right in his work.

What we need is not the destruction of private property; we need the restitution of private property. The restitution of the ownership of labor to the laborer himself, and the right to use his labor to produce real values regardless of whether there is any surplus income on capital investment.

Let me put it this way. Our present money economy is perverted, since in it the *person* is subordinated to consumption, consumption subordinated to production, and production is subordinated to profit. In the Nazi economy, the person is subordinated to consumption, consumption to production, and production to war. A *human* economy would regulate profit according to the service rendered by production, would regulate production according to consumption, and consumption according to human needs. To make a *human* economy it is not necessary to nationalize everything. In fact the nationalization of everything would produce a most inhuman form of state capitalism. The war itself is demonstrating that it is possible to regulate credit according to national needs. If this is realized for the purpose of producing guns and bombs, it will be impossible ever again to convince the people that a state cannot *afford* food and clothing for everyone. (Applause)

I have said there is a social revolution going on in the world. We do not even begin to grasp the magnitude of that revolution. I laugh when I hear some of my friends say that England is waging a war for capitalist and imperialist motives. If she is, she is making a bad bet. England will not be a capitalist country, in yesterday's sense of the word capitalist, at the end of this war. A complete transformation has already occurred in England.

The other day I had luncheon with a famous and wealthy Englishman. He said: " I have two houses in England " (that was a gross understatement—one of them is one of the dozen greatest houses in that land of great houses). " One of them is now a hospital, the other is a children's home. They were both given to the public during the last war, but the difference between this war and the last is that I know now I will never get them back." I murmured that was too bad, and he surprised me by saying—surprised me because he is an aristocrat and a Tory—" Oh, no! I think it's fine. It had to come. I have always had more than anybody needs, and I believe it will come in England without civil war and with a minimum of hatred."

A famous English scientist remarked the other day he hoped they would have Hitler on their hands for about three years, because by that time they would have been forced to do the things that were necessary anyhow, but that they would have been too indolent to do, except from necessity. The children who have been moved out of the city slums into country houses can never again be put back into city slums. Probably we shall see an ever greater decentralization of industry, and the shrinking of great cities all over European countries because of the fear of air raids. Nothing is more necessary in our

whole civilization than this very business of reducing the size of cities and getting industries tied up with agriculture—drawing their labor from farms to which in hard times the workers can return; tying up industrial life with country life, and so reëstablishing the neighborhood, that sense of community which is completely lost in the great metropolises. These, if any of Europe is left standing, will be assets from this war rather than liabilities.

In the field of politics and ideas I do not believe that the discipline which men and women have to undergo now in England and France in order to war on nazism will result in their becoming nazified. That is against all human psychology. On the contrary they are beginning in the Western countries to discuss a new charter of human rights as a basis of the war aims.

The other day I received a letter from H. G. Wells. He says the people of England and France are demanding an answer to the question, " What is this war being fought for? " —and he expressed the fear that the governments will fuss around with shifting boundaries and other things that nobody is interested in, except governments. He says that what the people want—the thoughtful ones—is a new declaration of the rights of man—including economic rights—which shall be made the basis for the reorganization of Europe and eventually of the world, as the Declaration of Independence was the prelude to our own Constitution.

Certainly Europe is thinking in this direction. It is rejecting the following premises of nazism and communism—the idea of racial superiority, the idea of class war, and the idea that basic freedoms need to be relinquished for economic aims, or that economic security is a substitute for political freedom. But in order to wage this war at all, all the belligerents are accepting a greatly increased measure of state capitalism. Pure capitalism depends upon freedom of movement of goods and money. War in any case impedes that freedom of movement. The American conception of neutrality further increases the restrictions. Just as this country aggravated the world depression by its unwillingness to accept European goods, so we now aggravate the tendency toward state capitalism by refusing to utilize our resources in foreign lending.

We bury the world's gold in a Kentucky mausoleum, increase its one-way flow by a cash and carry policy, and thus drive all European belligerents in the direction of state capitalism cut loose from an international money economy.

Since we cannot be part of an international money economy unless one exists, we shall, as the war proceeds, find ourselves genuinely isolated from the whole international price system. Then we must either adjust ourselves to the autarchic planned economy and state capitalism of the rest of the Western world, or take the lead, after the war, in reëstablishing an international money economy by contributing our own gold. Probably what will happen will be a combination of both.

In any case, the repercussions on America will be prodigious. It will be impossible to set up any kind of international financial structure after the war, which will include us, without our gold, and without an enormous *free* American contribution.

Social reasons will make it impossible to return anywhere in Europe to a pure profit economy. For war purposes all nations have made a demonstration regarding the possible uses of labor and resources which they will be unable, afterward, to repudiate. But if the Allies win, the humanistic ideas of democracy will triumph in Europe, for it is for these ideas—and these alone—that the ordinary man is enduring this hell. (Prolonged applause)

Remarks by the Chairman

Chairman Lamont: We thank you, Miss Dorothy Thompson, for this very thoughtful, this philosophical, this provocative address. The only horrid practice that the Academy of Political Science has, according to my way of thinking, is the mandate to its Chairman to make some serious remarks. Sometimes those are perpetrated at the beginning, sometimes at the end. But I did not know whether after General Johnson and Miss Thompson had finished their talks there might not be pieces to pick up. So I thought I would defer my effort until the end. I will say at the outset that what I shall have to say will be supplementary to a considerable extent to what Miss Dorothy Thompson has just said, but without her imagery of language.

(Chairman Lamont then spoke as follows.)

AMERICAN BUSINESS IN WAR AND PEACE

Economic Peace Essential to Political Peace

THOMAS W. LAMONT
Of J. P. Morgan & Co.

WHAT is the attitude of American business men toward war and peace? Although I have no mandate to speak for them, I venture to say it is this: First, to avoid armed conflict. Second, to encourage, rather than to obstruct, the efforts of the democracies to purchase here supplies vitally needed for their defense. Third, to make our country's economic and financial strength impregnable, so that finally America may be in a position to render sound and wise coöperation toward an enduring peace.

Why Business Detests War

I speak first of the determination to keep out of war because a few years ago a loud outcry, largely political, was raised that American business men have favored war because of the fancied profits flowing from armed conflict. There was never a charge more unfounded. There is nothing that business men the world over fear and detest quite so much as war. They know that there is no possible future for any sort of business, big or little, unless we can have peace, orderly means of production and good faith. The whole business world on both sides of the water is clearly appalled at the thought of another war and of the disastrous social, financial and economic consequences that are almost bound to follow it. I wish someone would run down the sources of the idea that business men are inclined to war. For example, in recent years we have seen Japan's aggression in Asia, and Italy's in Africa, and Hitler's repeated forays in Central Europe. Is there anyone in his right mind who would suggest that these acts of violence and of armed conflict have been favored or promoted by business interests?

Human Interests Rank First

The individuals and groups that have in recent years promoted this false legend, now clearly on the wane, seem to believe that business men think as a class and put their material interests above all else. They do not. They are human beings first of all, members of the general community. They love their country as warmly and in the same way as do our statesmen, our teachers, our professional men and our wage-earners—no more, no less. Their reflections about war and peace and democracy and civilization are on the whole the same as those of any other cross section of the community.

Bulwarks Against War

Today 95 per cent of our people, including business men, want to see the type of life and liberty that Britain and France are fighting for preserved from destruction. And at the same time 95 per cent of our people want to avoid war itself. Adequate and vigorous defenses for our country, the restoration and strengthening of America's domestic economy—these are the measures that will prove the best bulwark against war, the most helpful starting point for contribution to the peace. For business men know that without economic peace in the world there can never come a stable political peace.

A Continuing World Conflict

That lesson has, alas! been proved only too clearly by the history of Europe for the last twenty years. For the European world is not fighting a brand new war today. It is entering upon a third phase of the conflict that began in 1914. The second phase, the disastrous economic war, perhaps even more devastating than armed conflict, began almost the day after the Armistice in 1918 and, with only slight intermissions, continued for two decades. The third phase began with Germany's re-entry into the Rhineland in 1936, its absorption of Austria in 1938, its breach of the Munich Pact made in September a year ago, its crushing of Czecho-Slovakia last winter, and then finally the invasion of Poland last September. Perhaps, then, this present struggle is only the third phase of what in history may come to be known as the Second Thirty Years War.

America's Withdrawal from the Peace

Roughly, what were the fateful events in their sequence, beginning with 1919? First, then, as has so often been pointed out, America, having intervened in the war and having fought the good fight, withdrew completely from the peace. I am not for a moment attempting to argue the wisdom or unwisdom of our rejection of the Versailles Treaty and the other peace treaties and of the League Covenant, or of our dropping the Tripartite Treaty, signed by President Wilson at Paris, undertaking with Britain to come to France's defense against future German aggression. The fact is simply that we did withdraw. And thus treaties, which depended for their amelioration and enforcement upon the continuing participation of the United States in world affairs, were largely shorn of their constructive features.

British and French Aims Conflict

What next? With the tripartite treaty of defense gone with the wind, France said in effect: "Surely we shall find the Germans invading us again as in 1870 and 1914 unless we hold them down militarily and economically." Britain said, "No—to avoid trouble we should build Germany up." As the event showed, the three policies (America to withdraw, France to weaken Germany, Britain to strengthen it) all worked at calamitous cross purposes. I have perhaps over-simplified my history of the nineteen-twenties, but in essence I believe it is correct.

The War of Reparations

And as one of the consequences there was waged the thirteen-year economic war over German Reparations—what Germany should pay, what she could pay, what she should be forced to pay. That economic conflict, punctuated by the tragically unwise invasion of the Ruhr, had its disastrous repercussions not only throughout Europe, but to the furthermost corners of the globe, certainly including America. What marked its final phase was the complete financial breakdown of Central Europe in the spring of 1931. As a consequence in September of that year England was driven off the gold standard and its currency rendered so unstable that, after its payment to our government of almost a billion and a half dollars in cash on its debt—a fact that seems frequently to have been overlooked—it was unable to continue its payments to Washington.

Austro-Hungarian Break-up

No less a calamity, both political and economic, was the break-up of the Austro-Hungarian Empire, as confirmed by the Treaty of St. Germain. For generations the political entity of Austria-Hungary, despite its disparate racial elements and consequent political instability, had been a prosperous region of free and uninterrupted trade which acted for Central and Southeastern Europe as a great and fertile oasis of economic security, at the same time serving as a political bulwark against German aggression to the South and Southeast. Vienna was the great entrepôt for agricultural Hungary and industrial Bohemia. It was the centre of beneficent activities, an ancient city renowned for its progress in medicine, in music and in the arts. The Allied victory brought a wild release of emotions among the various racial elements of the Empire, and, under the several treaties, all this normally prosperous region was snipped into pieces, the remaining Austria being only a vestige of the old Empire, its glories gone, desolation and despair reigning in its doorways. On top of it all, separate tariff walls were set up, separate armies, air forces, and all the expensive and burdensome paraphernalia that go with modern-day armament, plus the intensest and most dangerous kind of nationalism.

America Responsible in Part

In this process of territorial and economic disintegration America must share some degree of responsibility with Britain, France and Italy, for, while President Wilson's ideal principle of self-determination of nationalities looked fine on paper, in practice it proved an altogether different cup of tea, and the dregs were bitter and devastating. And so the treaty of St. Germain stands out stark and menacing alongside that of Versailles which, despite all the violent criticism it has suffered, contained all the elements and constitutional provisions for constant revision—revision which might well have been steadily availed of had the United States not felt impelled to withdraw completely from the machinery of the peace.

Result of German Inflation

However, I must not overdramatize the past failures of the victorious powers, but rather turn to the ominous developments that took place inside Germany. The Empire of William II had laid the seeds for its economic downfall by attempting to finance its waging of the World War through loans rather than through heavy taxation. It had counted upon victory to bring rich financial fruits. Defeat intervening instead of victory, Germany made a desperate effort, before its currency faded into thin air, to foist its marks upon a rather naïve and credulous outside world. Despite extraordinary progress made by the Germans in this field of high financial endeavor, there came the Great Inflation that wiped out the German bourgeoisie—that great, sober, hard-working, middle class that, in an economic sense, had been the backbone of the Reich.

Violent Social Revolution

Thus what we have been witnessing in Germany since 1933, and even before, has been the progress of a violent and almost complete social revolution. A German friend described it to me in terms of a great tidal wave. It came rolling in, in great surges from the vasty deep, and, overwhelming the country, bore out to sea and oblivion the stable elements of the community, leaving cast up upon the shore all the strange creatures of the underseaworld of society. They are the ones that have been ruling the Third Reich with the strange and malevolent practices that have so shocked Western civilization. They are the ones who have taught the German people to ignore the frightful losses which they chose to incur in waging the World War, calculated as something like the equivalent of 100 billion dollars, and to attribute all their troubles, financial and other, to the Versailles Treaty.

Strength of Allied Cause

This, then, is a business man's rough sketch of the economic sequences in Continental Europe for twenty years past. What for the future? First, as to the war itself, the Allies must win. It is inconceivable that any man or nation should be able to compel the British and the French people to live in subjection to them and to adopt their mode of life. Man can never be both bond and free. It is against the nature of things that the Führer should be able to continue to overrun one sturdy and independent nation after another, declare it to be German whether it is or not, and expect it to remain a vassal state and part of the Reich. That cannot be done.

The very fact that the British and French seemed so slow in their preparations, their very reluctance to war, their perhaps almost naïve efforts for appeasement—these are factors that have strengthened rather than weakened the moral forces of these two countries, have hardened their determination to preserve their way of life, and have enhanced the sympathy felt for them by so many powerful neutrals, including our own country.

Britain Not Decadent

No, today, I am one of those who believe that England is not decadent. It is the same old country that in Elizabeth's time destroyed the Spanish Armada; in Marlborough's day was the backbone of the coalition against Louis XIV; under leadership of the younger Pitt was the backbone of the coalition which destroyed Napoleon; and in the World War so besieged Germany by sea as to hasten that weariness and exhaustion which, after Germany had won almost all the battles, lost her the War.

Let us suppose then, that Britain's sea power and France's wonderful army, magnificently equipped and led—and backed by the calm determination of the whole French people, so clear to the whole world—will bring victory to the Allies. What then? What of the peace? The suggestion that Britain and France should be able, with the knife at their throats, to sit down calmly and articulate in detail their peace aims is of course impossible. But in a larger sense many individuals and groups on both sides of the Atlantic are already asking the question and attempting to formulate the principle or idea of a new world order. In London questions are constantly being put in Parliament. The British press is filled with articles on the subject. Several important discussion groups in England and France are hard at work.

Economic Peace Essential to Political Peace

Whatever may prove to be the tenor of all these efforts, it is certain that there is one principle, to which I have already

alluded, that must be worked out. As has been indubitably shown by the lessons of the last twenty years, there can be no world political peace unless we have world economic peace. And what American business men and statesmen must realize, what the whole American community must understand, is that there can be no world economic stability without continuing American coöperation to help bring it about and sustain it. Because of America's vast importance as a world power, economically and politically, and because it is a thousand times harder to make the peace than to make the war, does it not follow that America's rôle is clearly, not to enter the war, but to make a great and valuable contribution to the peace?

What form of economic coöperation, necessary to establish peace, recovery and reëmployment, may be essential for us Americans to render, I have no present idea, any more than you. But we can be sure that, whatever it may be, it will mean for us the only way of avoiding the heavy sacrifices which we shall have to undertake if we are obliged to meet the disasters of continuing and recurrent world conflict and world disintegration, in which sooner or later we might readily become actively involved.

Economic Union in Europe

It is the scheme of an economic United States of Europe, that, both abroad and here, is being constantly discussed—an economic union not perhaps inclusive at the start but designed ultimately to embrace Western Europe. Briand had this vision and worked for it. Stresemann saw it. And do you recall that on the wall of the room in the Place des Vosges in Paris where he died Victor Hugo wrote: "I represent a party which does not yet exist. This party will make the Twentieth Century. There will issue from it first the United States of Europe, then the United States of the World."

Two Great Free Trade Areas

It is impossible to exaggerate the immensely stabilizing effects upon the world that a great free trade region in Europe would create. It would be measurably the counterpart of the great free trade area of our own United States, the most prosperous region on the earth. It would be creating a situation that tended strongly to remove at their very roots the causes of war. And the task of American economic coöperation to the end of an enduring peace cannot be confined to our government authorities alone. To have any chance of success it must command the active and intelligent support of the leaders of business and labor. They must put aside their ancient prejudices, must consent to reduced tariffs, and must make their thoughtful and determined contribution. Can a greater challenge ever be made to the intelligence, the farsightedness and courage of our American community?

The Hope of a Better World

Is there not hope of a better world to emerge from the confusion and strife of today? Even amidst the rigors and privations of the terrible Peloponnesian War, with Athens falling into ruins and Sparta bleeding to death, the Athenian philosophers and writers were yet dreaming of a better order, of a permanent peace, "A city", as Aristophanes styled it, "where rich and poor, man and woman, Athenian and Spartan, are all equal and free; where there are no false accusers, and where men"—or at least the souls of men—"have wings." That dream of twenty-three and a half centuries ago failed. In 1919 it failed. Must it fail, always and forever? May it not be possible at the peace that, with the European peoples, having the catastrophic failures of the last twenty years before their very eyes and willing as never before to place upon their sovereignties restrictions designed for a common good, the ultimate result even of this war will, despite the apparent paradox, mark a step forward in the evolution of Western civilization? May it not be possible that mankind will once more move onward and that General Smuts may at last, despite all intervening discouragement, be justified in that thrilling utterance of his twenty-one years ago: "The tents have been struck and the Great Caravan of Humanity is once more on the march." Upon what America is willing and able to do at the peace depends in very considerable measure the answer to these questions. (Applause)

Remarks by the Chairman

CHAIRMAN LAMONT: Once more we thank with all our hearts our speakers tonight, General Johnson, Miss Dorothy Thompson and Dr. Paul van Zeeland; and we thank again our friends here at this high table, for their favoring presence at this dinner. I now declare this Academy meeting adjourned.